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WHY DO THE MAJORITY OF MERGERS AND ACQUISITIONS FAIL?

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Manuel Nacha Giménez

Abstract

In the last decade, there has been a great increase in the number of mergers and acquisitions all over the world. This enhancement of the number of transactions is included in the most of the previous studies but moreover, many of these studies show that the majority of the mergers and acquisitions fail in the objective of creating value for the shareholders. This failure ratio is the reason which leads us to the next research question: *why do the majority of mergers and acquisitions fail?*

In this study, we introduce the basic concepts that must be known before answering the research question and the reasons that other authors have pointed out for explaining this failure ratio.

After this theoretical background, we conduct a comparative research of four cases, some of them with a successful result and some others with a failure one, in order to determine the key factors that explain the reasons why some of the mergers and acquisitions fail or success.

The study shows that there is a wide range of features when determining this failure or success. The analysis of the four case studies indicates that most of the reasons for this failure or success were previously considered by other authors, but some new reasons will be presented.

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1. INTRODUCTION

This chapter represents a brief introduction to the merger and acquisitions market, reasons for the existence, percentage of failure and reasons of failure. It also presents the research question and the aim of the study.

1.1 Background of the study

"Of course the merger was a success. Neither company could have lost that much money on its own"

Steve Case, Former Chairman of the board,
AOL\Time Warner

The terms mergers and acquisitions (M&A in the subsequent) are usually used indistinctly, but there are some differences between both terms. An acquisition occurs when a company buys another company and establishes itself as the new owner. The acquired company legally disappears and its stocks are not anymore in the market. In a merger, two companies decide to create a new company.[1]

One of the main objectives of merger and acquisitions is to be able to respond faster to the problems that a firm must confront everyday, including the new challenges that the new global economy represents. If they are accomplished in an effective way, they can increase the firm's revenues, the market share, improve the profitability and enhance the value for the shareholders.

There are several reasons for a company to acquire or merge. The most important are: economies of scale, channel control, risk spreading, cost cutting, synergies, defensive drivers, gain of word-class leadership, survival, acquisition of cash, deferred taxes, excess debt capacity, flexibility, biggest asset base to leverage borrowing, adopt potentially disruptive technologies, financial gain, personal power, gaining a core competence to do more combinations, talent and knowledge.[2]

In the last decade, there has been a great increase in the number and volume of mergers and acquisitions. In 2006, the market of M&A jumped by 30 per cent, reaching the amount of US $3.7 trillion which represents the highest level ever. This represents an increase of 9 per cent since the last record, which was settled in the year 2000.[3]

The US market was the most attractive market for investors, with a volume of $1.48 trillion, a 20 per cent up from the last year. There were 11,750 deals, which represents an increase of 6.7 per cent.

The European market traded $1.46 trillion, 60 per cent higher compare to the previous year, 2005. The number of deals was 12,006.[4]

The reasons that explain the increase of the M&A activity are numerous, but they can be summarized as: need for larger economies of scale, deregulation, globalization,

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[1] P.S. Sudarsanam, *"The Essence of Merger and Acquisitions"*(1995), p. 1
[2] *European Management Journal(2001)* Vol 19, nº3, p. 240
[3] *Mergerstat Review Edition (*2006)
[4] *Ibid*

expanding markets, risk spreading, need of rapid response to market conditions,[5] consolidation in many industries and the opportunities of dislocation.[6]

Although, there are some strong reasons for a company to merge or acquire, many studies have demonstrated that many mergers and acquisitions fail. According to some researches, between half and two-thirds of the M&A fail in the purpose of creating value for their shareholders…

Surprisingly, this failure ratio has not always been like this. According to some authors, mergers which took place in the 1960s and 1970s found out significant gains for shareholders of target firms. Consequently, shareholders of acquirers firms gained profits or broke even. These results were consistent with the reasonable economic expectation that buyers would bid up asset prices to their fair value.[7]

In the 1980s everything changed. Researchers have shown that shareholders of acquiring firms, upon the announcement of the acquisition experienced significantly negative results, over 16 per cent over the three years following the acquisition.[8]

Faced with the facts of acquisition performance, academics have explained them in two basic different ways: (1) managers attempt to maximize shareholder value by either replacing inefficient management in the target firm or achieving synergies between the two firms, or (2) managers pursue their own objectives such as growth or empire building at the expense of shareholder value. These hypotheses are an attempt to understand the average results of acquisitions.[9]

Due to the important losses that failing mergers and acquisitions can bring to the shareholders, it is important to understand the reasons why they can fail, because understanding them is a previous preliminary step that should be taken into account to conduct successful acquisitions. This need has led us to the following research question:

1.2 Research Question

Why do the majority of mergers and acquisitions fail?

1.3 Aim of the study

The objective of the study is to explain why the majority of the M&A fail. Once the reasons are outlined, companies should take them into account if they want to build a successful plan before bidding for another company.

The study can be of great interest for those companies which are thinking about acquiring another company or some of them which are planning to merge with another one.

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[5] *European Management Journal* (2001) Vol 19, nº3, p. 239
[6] Meredith M. Brown, *" International Mergers and Acquisitions"* (1999), p. xv
[7] Mark K L. Sirover., " *The SynergyTtrap"*(1997), p. 11
[8] E. Tatum Christiansen, **"** *Sears, Roebuck &Co. in the 1980's: Renewal and Diversification",* Harvard Case 9-386-029, p. 10
[9] Mark K L. Sirover., " *The SynergyTtrap"*(1997), p. 11

2. THEORY REVIEW

This chapter provides the reader with the theoretical concepts that (s)he must know before continuing with the rest of the study. It also represents a further study of some of the concepts underlined in the introduction.

2.1 Concepts related to mergers and acquisitions

The main ideas about what a merger and an acquisition are will be developed here. There are different ways to classify them and some of these classifications may be valid for both mergers and acquisitions.

Before continuing with our study, we will define some other concepts that are important for the careful readers and for the global understanding.

Takeover is a wide and a non accurate concept which could be narrowed down like a transfer of control of a firm from a group of shareholders to another, where control usually means to have the majority vote on the board of directors.

The firm that has planned to take over another firm is referred to as the bidder. This one will offer cash or securities to obtain the stock or assets of another company, which is referred to as the target. Once the offer is accepted the target firm will cease its activity transferring stocks or assets to the bidder.[10]

As we have just mentioned, the concept of takeover is wide because it can be broken down in M&A, but it can also refer to as proxy contest, which *"occurs when a group of shareholders try to get controlling seats on the board of directors by voting in new director"* and going-private transactions, that means *"all the equity shares of a public firm are purchased by small group of investor"*[11]

In a merger, the companies combine and share their resources to achieve objectives established together. The shareholders of both companies remain as owners of the new company.[12]

There are three types of mergers: horizontal, vertical or conglomerate.[13] In a horizontal merger, the two companies who merge operate in similar businesses, for example two petroleum companies. Vertical mergers occur in different steps of the production process. An example would be the merger between an airline company and a travel agency. In conglomerate mergers, the industries of the two companies are not related. The merger between a food-product firm and a computer firm for instance.

In an acquisition, one of the companies purchases the assets or shares of the other one, and the shareholders of the acquired company stop owning the company. The acquired company becomes a subsidiary of the acquiring company.[14]

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[10] Ross/Westerfield/Jaffe *"Corporate Finance"* (2005), p. 798
[11] Ibid, p. 799
[12] Andrew J. Sherman and Milledge A. Hart, *"Mergers and Acquisitions From A to Z"*, p. 11
[13] J. Fred Weston and Samuel C. Weaver, *"Merger and Acquisitions"* (2001), p. 21
[14] P.S. Sudarsanam, *"The Essence of Merger and Acquisitions"*(1995), p. 1

An acquisition can be friendly or hostile. When the acquisition is friendly, the bidder has the support of the management of the acquired company, who recommends to the shareholders of the acquired company to sell the stocks. In a hostile bid, the management of the acquired company is against the acquisition. The friendly bid is cheaper, less risky and smoother.[15]

However, other authors provide us with another way of defining and classifying mergers and acquisitions, as can be observed in the subsequent. We can approach this issue taking into account three basic legal procedures of acquiring firms: [16]

-Merger involves the idea of absorption of one firm by another one. The acquiring firm holds its denomination and identity and the acquired firm loses all its assets and liabilities and, consequently, finishes its activity as a different business entity. According to these authors, this concept is related to the idea of consolidation. This is the same as merger except that a new entity will be created.

-Acquisition of stock. The main objective here is to purchase the firms´ voting paying cash, shares of stocks, or other securities. The process is the same in most of the cases. A private offer from a firm to another followed by the acceptance of the selling firms´ stockholders. Then by using a tender offer, referred to as *"a public offer to buy shares of a target firm, where the offer is communicated to the target firms´ shareholders by public announcements"*, this can be accomplished.

-Acquisition of assets. By acquiring other firms´ assets the acquiring company can avoid the potential problem of facing the minority shareholders that can happen in an acquisition of stock.

We will not develop deeply the pro and cons of choosing different approaches because we think it is not required given our research question. By contrast, we would like to make clear the difference of some factors between a merger and an acquisition of stock[17], once it was distinguished above:

- There is no shareholder meeting in acquisition of stock. If the shareholders of the target firm do not accept the offer, they can choose not to sell.
- Acquisition of stock is sometimes unfriendly. Due to this reason, the cost of acquisition by stock is higher than by merging.
- It might occur that a minority of shareholders will hold out in a tender offer. Therefore the target firm can not be completely absorbed.
- Complete absorption must involve a merger. Some of the acquisitions of stock end in mergers.

[15] P.S. Sudarsanam, *"The Essence of Merger and Acquisitions"*(1995), p.128
[16] Ross/Westerfield/Jaffe*"Corporate Finance"* (2005), p. 797
[17] Ibid, p. 798

2.2 Strategic alliances[18]

It is important to make a difference between strategic alliances and mergers and acquisitions, since many times these concepts are mixed up.

A strategic alliance is an agreement between two or more companies that co-operate in order to achieve some commercial objectives. Alliances are different from mergers and acquisitions since they are usually much larger, more difficult to manage, and many times the duration and the focus of the alliance are not known.[19]

Well structured alliances can be a less expensive alternative to acquisitions, but the failure percentage is almost the same.

There are different types of strategic alliances:

- Supply or purchase agreement
- Agreement to provide technical services
- Management contract
- Marketing or distribution agreement
- Licensing
- Franchising
- Joint venture (sometimes is considered different from other strategic alliances)[20]

All these kinds of agreements are non-equity agreements. The only case that can be an equity agreement are joint ventures. The difference between an equity agreement and a non-equity one is that in an equity agreement a new jointly owned company is created.
There are some critical factors that can lead to the success of an alliance:

- The companies that make the alliance may have complementary skills and market positions.
- The market overlap between the companies should be small in order to minimize a possible conflict of interest.
- The alliance has to be managed with a high degree of autonomy, but with a continued support from the companies that take part in the alliance.
- There must be confidence between the partners.
- Cultural fit must be taken seriously into account.

There are six guidelines that must be followed in order to create a successful alliance:[21]

- Develop clear and common objectives.
- Ensure a proper alliance form.
- Determine the appropriate governance model.
- Anticipate conflicts.
- Establish a plan for evolution.
- Establish clear metrics for measuring the success.

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[18] P.S. Sudarsanam, *"The Essence of Merger and Acquisitions"*(1995), p.280
[19] Patricia Anslinger and Justin Jenk, *"Creating Successful Alliances"*
[20] J. Fred Weston and Samuel C. Weaver, *"Merger and Acquisitions"* (2001), p. 127
[21] Patricia Anslinger and Justin Jenk, *"Creating Successful Alliances"*

2.3 Objectives of merger and acquisitions

There are two perspectives for understanding the objectives the companies have for starting a merger or an acquisition: the maximization perspective of shareholders´ wealth and the managerial perspective.[22]

In the first one, according to the shareholders´ wealth maximisation perspective, the firm's decision to merge or acquire another company is based on the fact that companies look for the maximisation of the wealth of the shareholders. The maximisation of the value of the shareholder takes place when the net present value of the investment is positive.

According to the managerial perspective, managers´ motives for mergers and acquisitions can be the next[23]:

- To increase the size of the firm since their status, remuneration and power depend on the firm size (the empire-building syndrome) .[24]
- To improve their managerial skills (self-fulfilment motive).
- To diversify the risk and to avoid being acquired by another company (job security motive).

2.4 What does failure mean?

There are many points of view for answering this question, but most of the researchers conclude that an M&A fails when the acquirer company does not increase the value for their shareholder. It also may happen when it does not achieve the financial, commercial or strategic objectives.[25]

2.5 Mergers and acquisitions´ failure costs

There are some different failure costs of non successful mergers and acquisitions:

-Lower share prices. In the last three decades, the average acquirer lost almost 4 per cent of its value. In firms by the issuance of equity, acquiring lost over 6 per cent of its value.[26]According to a study carried out by Dodd[27], *"stockholders from acquired companies win an abnormal sum of money (13% at the moment of the announcement, and 33.96% during the duration of the merger proposal)"*. In the cases of bidder companies, the case is the opposite, representing a loss for the shareholders of –7.22% and –5.5% during the duration of the proposal.

-Decrease in profitability. According to a research conducted by Shenk, *"approximately 60% of the mergers result in lowered profitability for as long as seven years post merger, comparing to a control group of non merger companies"*.

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[22] P.S. Sudarsanam, *"The Essence of Merger and Acquisitions"*(1995), p.14
[23] Ibid, p.16
[24] Firth, M. *"Takeovers, Shareholder Returns and the Theory of the Firm,"* (1990), Quarterly Journal of Economics, 44(2), 235-260.
[25] Denzil Rankine, *"Why Acquisitions Fail"*, p. xxi
[26] Andrade, Mitchell, and Safford, *"A Journal of Economics Perspectives Report"* (2001)
[27] Dodd P., *"Merger Proposals, Management Discretion and Stockholder Wealth"* (1980), Journal of Financial Economics 8(2), 105-137

According to a study by David J. Ravenscraft and F. M. Scherer, including 95 mergers, the profitability after the merger was the following[28]:

All 95 tender offer targets	-0.973%
25 companies taken over by acquirer incumbent management opposed	-2.281%
20 companies acquired by white Knights	-0.558%
50 companies acquired in other tender offers uncontested by management	-0.486%

-The gain in productivity after a merger is almost zero. According to a research conducted by Antoinette Schoar, *"firms that merge or acquire other companies suffer from a reduction in the productivity. Although acquired plants increase their productivity, the plants of the acquirer company suffer a loss in profitability".*[29]

The productivity in the eight months after the deal can be reduced by a 50 per cent.[30]

-The loss of market share. According to a study conducted by Dennis C. Mueller, *"no support was found for the proposition that mergers improve efficiency by consolidating the sales of the acquired companies on their most efficient product lines".*[31]

-Bad bidders usually become good targets for other companies. About 40 per cent of the firms that fail in the acquisition of a company become targets for other companies.[32] This is due to the fact that, most of the times, the price of the stocks of the bidder company gets down after the announcement of an acquisition, reducing the price of the shares.

-Loss of executives in acquired companies, 47 per cent of executives leave within the first year, and 75 per cent leave within the first three years.[33]

This is a serious problem since this executives represent the key people of the acquired company, and without their help, the integration between both companies becomes a tough task. Apart from the loss of key employees, there is another consequence that can occur if the integration process is not correctly accomplished, which is the employee's loss of motivation. If the merger is not communicated properly, and the objectives underlined clearly, employees may experience some doubts that can damage the productivity of the company.[34]

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[28] David J. Ravenscraft, F.M Scherer, *"Life after Takeover"*(1087), p. 149
[29] Antoinette Schoar "*Effects of Corporate Diversification on Productivity*" (2002) The Journal of Finance 57 (6), 2379–2403.
[30] Timothy J. Galpin and Mark Herndon, " *The Complete Guide to Mergers and Acquisitions"*(2000), p. 2
[31] Dennis C. Mueller, University of Maryland, College Park and Federal Trade Comission
[32] Mark L. Mitchell and Kenneth Lehn, "*Journal of Political Economy"*(1990), vol.98, nº2
[33] Timothy J. Galpin and Mark Herndon, " *The Complete Guide to Mergers and Acquisitions"*(2000), p. 2
[34] Denzil Rankine, *"Why Acquisitions Fail"*, p. 155

-The expected synergies for M&A are only reached in 30 per cent of the cases.[35] In most of the acquisitions, achieving the synergies is necessary to make the acquisition succeed, since the price paid is related to these estimated synergies. As we will explain later, there are four different types of synergies: revenue enhancement, cost reduction, lower taxes, and lower cost of capital.[36]

-Brand confusion. In many M&As, one or more of the brands are lost, and that can generate some doubts between the customers of both companies.[37]

-Decrease in customer satisfaction. When two companies do not success in the process of merging, the final customer will be the first who will suffer from this. This happened with the merger between Aetna and U.S. Healthcare, which lead to a decrease of 40 percent in the profits of the new generated firm.[38]

During the integration process, executives of the companies focus on the integration of both companies and many times they forget to focus on their clients. The ability of a company to access to the clients of the acquired company depends on the reaction of the clients and suppliers of the acquired company. For the success of an acquisition, the customers´ reaction must be positive.[39]

2.6 Percentage of failures

There have been many researches that have tried to analyze the percent of failure in mergers and acquisitions. Many of them will be summarized in the next table[40]:

Table 2-1 Surveys showing that acquisitions do not add value

Source	Sample	Time frame	Per cent failed%	Measurement
Michael Firth- Economic Journal, 89 (1979)	224	1972-74	79	Share price in following four years
Byrd & Hickman	128	1980-87	66	NA
Mckinsey	116	Completed 1987	61	Cost of capital in three years
Mitchell/EIU	150	1988-96	70	Would not buy again (self assessment)
Mark Sirower, The Synergy Trap	168	1979-90	65	Absolute returns for up to four years
J P Morgan	116*	1985-98	44	Excess return relative to local market
A T Kearney	115 **	1993- 96	58	Share price relative to industry index after three years
Mercer Management consulting	150	Completed 1995	57	Share price relative to industry index after three years
Coopers & Lybrand	125	Completed 1996	66	Revenues, cash flow, profitability
Mercer Management	215	Completed 1997	48	Share price relative to industry index after three years
KPMG	107	1996-1998	53	Share price relative to industry index

*European acquisitions; ** Global mergers

[35] Timothy J. Galpin and Mark Herndon, *" The Complete Guide to Mergers and Acquisitions"*(2000), p. 2
[36] Denzil Rankine, *"Why Acquisitions Fail"*, p. 73
[37] Timothy J. Galpin and Mark Herndon, *" The Complete Guide to Mergers and Acquisitions"*(2000), p. 2
[38] Ibid, p. 3
[39] Helen Anderson, Virpi Havila, Joham Holström, *"Are Customers and Suppliers Participants of a Merger or Acquisition?"*, p.1
[40] Denzil Rankine, *"Why Acquisitions Fail"*, p. xxi

2.7 Why do mergers and acquisitions fail?

The reason for including this point inside the theoretical review is that our purpose is to analyse what other authors have written about this topic, and through our study, verify if these ones are the real reasons, and find out some other arguments that have not previously been considered by other authors.

Mergers and acquisitions can fail for many reasons as we can see in the subsequent:

-Target management attitudes and cultural differences. The culture of a company is the set of beliefs, assumptions and accepted rules of conduct that defines how a company works.[41]

According to a survey carried out by Coopers and Lybrand in 1993, focused in the UK's top 100 companies, this one is the main reason for failure cited by top managers (85 per cent).[42]

Culture difference refers to the way the decisions are taken in the acquirer and acquired companies. Many of the managers of acquirer companies felt that the managers of acquired companies lost self-motivation and entrepreneurial instincts. In most of transactions, the acquirer company imposes its culture to the acquired company. Although this strategy can work sometimes, most of the times this is a perfect way of destroying value.[43]

-No post-acquisition integration planning. Integration planning is needed since integration between the acquirer and the acquired company depends on the ability of integrating the two companies. An integration plan is needed in order to achieve the synergies[44]. According to the same Coopers and Lybran's study, this is the second most cited reason for failure.

In every deal where there is a need of incorporating employees into new processes and objectives, the integration planning process should begin at the same time as the due diligence process.[45]

This integration plan should include:[46]

- A review of the strategies of the two companies in order to ensure that the deal makes sense.
- Develop a vision and common goals for the resulting company.
- Develop integration goals and a schedule for achieving these goals, and use them for communicating successes to the employees.
- Establish operating principles and critical success factors in order to enhance the firms´ core values and make the philosophy of the firm clear for all the employees.

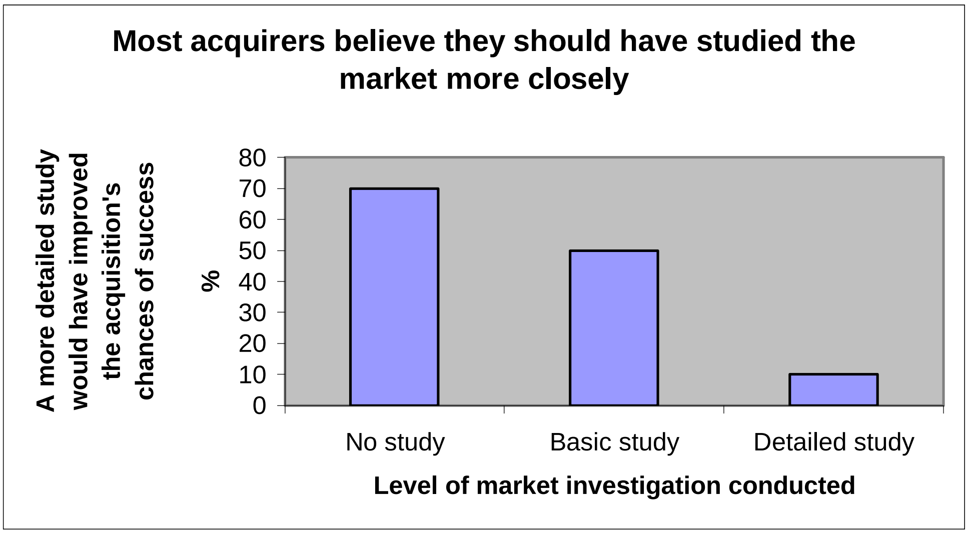
[41] Max M Habeck, Fritz Kröger, Michael R Träm, *"After the Merger"*(2000), p.84
[42]P.S. Sudarsanam, *"The Essence of Merger and Acquisitions"*(1995), p.231
[43] Max M Habeck, Fritz Kröger, Michael R Träm, *"After the Merger"*(2000), p.81
[44] Denzil Rankine, *"Why Acquisitions Fail"*, p. 155
[45] Teresa A. Daniel and Gary S. Metcalf, *"The Management of People in Mergers & Acquisitions"*, p. 65
[46] *Ibid*, p. 66

-Lack of knowledge of industry or target firm. This knowledge includes issues like examination of manufacturing facilities, product design facilities, rejections rate, marketing net works, profile of key people and productivity of the employees.[47]

The acquirer company needs to know how the target company works, its competitive advantages and the critical success factors for achieving revenues.

The next graphic shows the belief of most of the acquirers that they should have studied the market more closely.[48]

Fig 2.1 Most of acquirers believe that should have studied the market more closely



Source: AMR International, 2001

-No prior acquisition experience. This fact must be considered when one analyses the causes of failure of a merger or an acquisition. It is important to know if the acquirer company has previous experience in acquiring other firms. From previous errors and successes, companies can learn important lessons for other acquisitions.[49]

- Following a wrong strategy. If a company is following a wrong strategy, the possibilities of acquiring the wrong company are much bigger.[50] The chances for success in a transaction increase when the acquirer company focuses on known industries and countries.[51]

-Do not consider other options. Sometimes managers do not consider alternative options for a merger or an acquisition. The different alternatives to merge or acquire depend on the objective followed. If the objective is the growth of sales, the alternatives

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[47] Hariharan, P.S., *"Pitfalls in Mergers, Acquisitions and Takeovers (A-Z of Merger Failures)"* (2005), The Management Accountant, 40(10), 763-766.
[48] Denzil Rankine, *"Why Acquisitions Fail"*, p. 52
[49] Sudarsanam, S. and A.A. Mahate, *"Glamour Acquirers, Method of Payment and Post-Acquisition"* (2003), Performance: The UK Evidence, Journal of Business Finance and Accounting, 30(1-2), 299-341.
[50] Denzil Rankine, *"Why Acquisitions Fail"*, p. 52
[51] Ibid, p. 20

of merging are joint ventures or organic growth. If the reason is to improve earnings, the alternatives might be to divestiture of efficiency measures. When the objective is to reduce dependence in one business sector, the alternatives may be to build smaller areas or test new areas. Sometimes the reason for merging is to invest the excess of cash. In those cases, the alternatives can be joint ventures or returning cash to the owners. Finally, if the objective is to improve the management of the company, the alternatives can be board decisions and the use of consultants.[52]

-Overestimate potential synergies

"There are some synergies here for sure. I don´t know where they are yet. To say that now would be an idiot's game"

Barry Diller, commenting on QVC's proposed strategic acquisition of CBS in 1994

The reason for acquiring companies is the assumption that both companies, working together, will increase the value for the shareholders. The net present value (NPV) of an acquisition equals to the synergy less the premium paid:

NPV = Synergy – Premium[53]

While synergy can be define as,

Synergy = Vab – (Va + Vb)[54]

Where:

Vab = Value of combined firm

Va = Value of company A

Vb = Value of company B

Thus, "*the difference between the value of combined firm (Vab) and the sum of the values of the firms as separate entities is the synergy from the acquisition, while Va and Vb can be obtained by observing the market price of the outstanding securities*"

If the real synergy is not as big as expected, depending on the premium that it is paid, the net present value of the acquisition can be negative, and this is something that usually occurs.

-Paying too much. This failure is related to the former one. If the price of the premium is higher than the value of the synergies, then the net present value is negative. One of the reasons pointed out by some authors for paying too much is that during a competitive bidding situation, a company can tend to pay more.[55]

[52] Denzil Rankine, *"Why Acquisitions Fail"*, p. 95
[53] Mark K L. Sirover., "*The SynergyTtrap"*(1997), p. 20
[54] Ross/Westerfield/Jaffe *"Corporate Finance"* (2005). p. 802
[55] Roll, R., "*The Hubris Proposition of Corporate Takeovers"*(1986), Journal of Business, 59/2, 197-216.

The next table shows the premiums that have been usually paid during the 90s.[56]

Table 2.2 Percent premium offered 1990-1999

Year	***Average***	***Median***
1990	42	32
1991	35.1	29.4
1992	41	34.7
1993	38.7	33
1994	41.9	35
1995	44.7	29.2
1996	36.6	27.3
1997	35.7	27.5
1998	40.7	30.1
1999	43.3	34.6
Mean	**40**	**31.3**

Source: Mergestat Review

Not always paying a high premium means that the return is going to be lower. As we can see in the next table, there are many examples that show that bigger premiums have brought higher returns.[57] The reason that explains this fact is that even if one company pays a higher premium than another company, the synergies can be higher, creating more value for the shareholder.

Table 2.3 Low premium deals with low returns

Acquirer's name	**Target's name**	**Premium**	**One-year market return**
Marshall & Ilsley	Valley Bancorp	19%	-17%
Ceridian	Comdata Holdings	19%	-16%
Durco international	BW/IP	14%	-17%
3com	U.S. Robotics	13%	-46%
Bergesen	Havtor	11%	-21%
AT&T	McCaw Cellular Communications	11%	-17%
Dresdner Bank	Kleinwort Benson	10%	-16%
Washington Mutual	Great Western Financial	6%	-9%
Advanced Micro Devices	NexGen	5%	-59%
Ultramar	Diamond Shamrock	1%	-18%

[56] J. Fred Weston and Samuel C. Weaver, *"Merger and Acquisitions"* (2001), p. 83
[57] Harvard business school press, *"Harvard Business Review on Merger and Acquisitions"*,(2001) p.49

Table 2.4 High-premium deals with high returns

Acquirer's name	Target's name	Premium	One-year market return
Allegheny Ludlum	Teledyne	115%	33%
First Bank System	U.S. Bancorp	85%	12%
Northorp	Grumman	65%	12%
Healthsouth	Surgical Care Affiliates	61%	30%
Praxair	CBI Industries	49%	49%
Crompton&Knowles	Uniroyal Chemical	45%	7%
Williams Companies	Transco Energy	43%	19%
CAN Financial	Continental Corporation	39%	48%
Kvaemer	Trafalgar House	35%	15%
Frontier	ALC Communications	34%	4%

-Wrong management of the integration. If managers do not manage to integrate the two companies in the new strategy, the consequence will be a failure. There can be some reasons for not achieving this goal, like a poor communication, wrong steps for the implementation of the change, underestimation of the scale of the task and a lack of clear leadership.[58]

-Ignoring customers during the integration[59]. They are the essential part of a company. During an integration process, the risk of focusing on the internal part of the company and forgetting that the ones who keep the company alive are the clients exists.

-Do not examine the financial position. Before acquiring a company, an audit of the target company should be done in order to collect valuable information relating some issues as value and quality of the receivables, litigation problems, etc.[60]

-Incomplete or inadequate due diligence. Due diligence should be done in order to avoid some problems after the acquisition of a company. A due diligence identifies problems which should be resolved in order to achieve the success of the acquisition. It also provides a forecast of the business performance and provides information on the way a company is positioned and managed.[61]

2.8 Why do some mergers and acquisitions succeed?

We have mentioned that most of the mergers and acquisitions fail in their objective of creating value for the shareholders. There are many reasons that can contribute for the failure of an acquisition, but there are some companies that succeed in the acquisition process. Which are the reasons for being successful?

[58] Denzil Rankine, *"Why Acquisitions Fail"*, p. 145
[59] Ibid, p. 213
[60] Arnold, G., *"The Handbook of Corporate Finance"*, A Business Comparison to Financial Markets Decisions and Techniques, (2005), Financial Times, Prentice Hall.
[61] Denzil Rankine, *"Why Acquisitions Fail"*, p. 87

- A detailed post acquisition integration plan, according to the study of Coopers and Lybrand, which was commented before. This was the main reason cited by the executives of the top 100 UK´s companies (76 per cent of the executives).[62]

This plan should be focused on the need of the employees of working together for fulfilling the objectives of the new company.

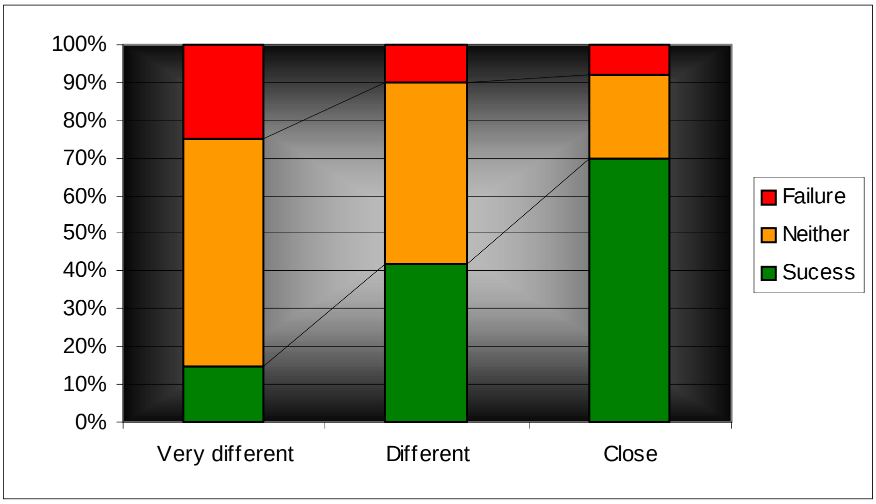
-Speed of the integration. If the integration is quickly accomplished, there are more chances of success. The key members of the two companies should be devoted to the integration process and focused on the important facts for succeeding in the acquisition.[63]

-Clarity of acquisition purpose. According to the study of Coopers and Lybrand, this is the second most answered reason for success. If the objectives of the transaction are clear, employees will be able to adjust themselves faster to the new objectives and in a better way.

-Good cultural fit. This is the third reason, according to the study of Coopers and Lybrand.

The next figure is very illustrative to represent the chances of success depending on the cultural gap.[64] The lower the cultural differences are, the bigger the chances of success.

Fig. 2.2 Chances of success depending on the cultural gap



Source: AMR International, 2001

When the two companies serve very different markets, the best choice is to keep the two different cultures as they were before the integration. When the two companies need to be completely integrated, they should create a compound culture taking the best things of each culture.[65]

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[62]P.S. Sudarsanam, *"The Essence of Merger and Acquisitions"* (1995), p.231
[63] Teresa A. Daniel and Gary S. Metcalf, " *The Management of People in Mergers & Acquisitions*", p.202
[64] Denzil Rankine, *"Why Acquisitions Fail" (2001)*, p. 205
[65] Max M Habeck, Fritz Kröger, Michael R Träm, *"After the Merger"*(2000), p.81

-High degree of target management co-operation. This reason was cited by the 47 per cent of the executives. For the success of a transaction, the managers of the acquired company have to collaborate in the integration of both companies. This is really difficult to carry out since many times ego problems can surge, or other type of problems like being afraid of losing their jobs.

-Knowledge of target and its industry. This is the fifth most important reason according to the same study (it was mentioned by 41 per cent of the interviewees).

Companies that are working in the same industry can make money in a wide range of ways. The different companies can focus on different competitive advantages. The acquirer company has to know fairly accurately how the target company works and the industry where they work. If the acquirer company misleads in doing this, the consequence can be a failure.[66]

2.9 Sources of synergy from M&A[67]

There are four main sources of synergies: revenue enhancement, cost reduction, lower taxes, and lower cost of capital.

-Revenue enhancement. The key idea that we are developing here is that a combined firm will obtain higher revenues than both firms working as individual. There are three main reasons why this revenue enhancement is achieved: marketing gains, strategic benefits and market power:

- Marketing gains, due mainly to a former ineffective media advertisement and an increase of the same during the process of M&A.
- Strategic benefits. The thing is that the firm will be well positioned in the new and changing environment after a merger or an acquisition. The company aims to take a competitive advantage.
- Market or monopoly power. When a company acquires another one in order to increase monopoly profits, prices can be increased. However by doing this practice the competition is reduced and the costumers affected. That is why this is not allowed by the different Competence Regulatory Commissions.

-Cost reduction. Efficiency is the key word here. Within the successful mergers, the is the reason why most of them succeed. Firms will accomplish greater operating efficiency by lowering costs in different ways:

- Economies of scale. This is a very familiar concept that can be summarized as the decrease of the average cost of production due to an increase in the amount of production. This concept is usually related to horizontal mergers.
- Economies of vertical integration. Some travel companies acquire leisure, car rental, airlines, and hotels companies to close the whole process in a determined industry.
- Elimination of inefficient management. It can be reached by integrating related activities within a process, obtaining fewer bottlenecks and waiting times and mechanizing different process of production.

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[66] Teresa A. Daniel and Gary S. Metcalf, *"The Management of People in Mergers & Acquisitions"*p. 199
[67] Ross/Westerfield/Jaffe *"Corporate Finance"* (2005) p. 802-806

- Complementary resources. For instance a sky-equipment store would like to merge with a golf one. They could use the existing resources and produce more sales in both the winter and the summer seasons by achieving a better use of store capacity.

- Lower taxes. Tax gains motivate a great number of acquisitions. There are several ways of decreasing taxes:

- The use of tax losses from net operating losses. It is known that if two firms merge they will pay lower taxes. If they remain separate this advantage of potential tax losses is not possible. But this issue is regulated by the federal tax law in USA for instance.
- The use of unused debt capacity. In finance everybody is familiarized with Modigliani and Miller Prepositions, which involve the idea of the optimal capital structure. When referring to capital structure it is assumed to talk about debt-equity ratio for non-familiarized readers. It will be optimal when the marginal tax benefit from additional debt is equal to the marginal increase in the financial distress costs from the additional debt, when financial distress can be explained as the pressure that a firm must face, due to the high leverage ratios, which is a risk that put pressure and uncertain in the firm and consequently might involve bankruptcy. In many cases, when firms merge the cost of financial distress is lower than the sum for the two separate firms because of the diversification. Therefore, after a merger or an acquisition firms are able to increase its debt-equity ratio with a higher profits because additional tax benefits are created.
- The use of surplus funds. If firms have free cash flows, there will be several ways to spend them. By paying dividends and by buying their own shares and then acquiring shares from another firm, for instance. When a firm decides to do the latter, there will be two goals carried out. First, the firms´ shareholders avoid taxes from dividends that would have been paid. Moreover, the firm save money paying lower corporate taxes on dividends received from the acquired firms´ shares because 70 per cent of the received dividend income is excluded, according to different regulations.

-Lower cost of capital because of the economies of scale accomplished when issuing securities in a merger. The costs of issuing both debt and equity are lower for larger issues than for smaller.

2.10 Why merge or acquire another company if so many deals fail?

There may be many reasons, but the most important are those when a merger or an acquisition can give the opportunity to a really big and fast growth and can improve the profitability if the transaction is well done.[68]

Most of the times, the reasons expressed by employees for acquiring a company are the growth in sales, growth in earnings, reduce the dependence in one business segment, invest the excess of cash and improve the management of the acquired company.[69]

[68] Teresa A. Daniel and Gary S. Metcalf, *"The Management of People in Mergers & Acquisitions"*, p. 10
[69] Bruce Lloyd, *"Creating Value Through Demergers Buyouts and Alliances"*, p. 168

As an example of two different motives for merger, we can take the cases of Cisco and Exxon.[70]

Between 1993 and 1999, Cisco acquired 43 companies supposing a total of $20 billion. These ones involved growth and expansion strategies.

The merge between Exxon and Mobil was worth $81 billion. In this case, the petrol industry is a mature sector. The objective was to increase market share, decrease competition, and improve efficiency.

2.11 Trends in merger and acquisition activity[71]

In the last years, the merger and acquisition activity has been experiencing a great change. The biggest changes are:

- Deals are driven more strategically. The decision to merge or acquire another company needs an intelligent and clear corporate strategy.
- Technological advances are driving deals. In a world that is experiencing huge technological advances every day, sometimes is cheaper and easier to acquire technology rather than building on your own.
- Globalization is bringing more deals. Companies are trying to access to the new markets, and one way of doing it is to acquire local companies.
- Deals are made between larger corporations.
- Entire industries are involved in this acquisition activity. The change in customer demands, social policies and deregulation are bringing consolidation in whole industries. The best examples of this are the financial services, health care and telecommunications industries.
- Managers are smarter about how to make deals and how to manage integration. After experiencing a huge failure rate for many years, managers and business schools have realized about the importance of the problem.
- Workers are more crucial for the success of the merger and acquisition. Human assets are worth much more than before since the know–how of the acquired company is needed in order to keep operations running.

2.12 What does the value of a firm mean?[72]

There are different concepts of value:

- Intrinsic value: Is the net present value of expected future cash flow independently from any acquisition.
- Market value: The market can add a premium to the intrinsic value to reflect the possibility that a company should make an offer to acquire the company.
- Purchase price: Is the price that a bidder company think it will have to pay in order to be accepted by the shareholders of the target company.

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[70] Theresa A. Daniel and Gary S. Metcalf, *"The Management of People in Mergers & Acquisitions"*, p.1
[71] Mitchell Lee Marks, *" Consulting in Mergers and Acquisitions, Interventions Spawned by Recent Trends"*, p. 4
[72] Harvard business school press, *"Harvard Business Review on Merger and Acquisition"* (2001), p.51

- Synergy value: The synergy value is the net present value of the cash flow that will result from the improvements that are made when the two companies are combined.

The value gap is the difference between the purchase price and the intrinsic value, which is commonly named as premium.

2.13 Methods for valuating projects. Profitability and growth

This is hard to approach, given the density of several concepts. As finance students, we will focus on the issues related to the financial statements when valuating projects but we will try to develop the main concepts for all kinds of readers. We could be broader in this epigraph but we will try to summarize the main ideas due to the vagueness of some concepts and the limitation of our research question.

Besides the discount cash flow model (DCF), we know other methods for valuating projects and assessing their profitability. We talk about Residual Earning model (RE) and Abnormal Earning Growth (AEG).

Residual Earning model is connected to the Price-to-Book ratio (P/B) and its concept of book value which involves shareholders´ investment in the firm. Book value is also defined as assets minus liabilities, which is net assets. The main concern here is to know how much the investment (net assets) is expected to make in the subsequent period(s) of time. Thus, depending on the future earnings which a firm is expected to generate, the book value will be higher or lower. [73]

Residual Earning measures the earning in excess compared to the required rate of return. Therefore, an investment expected to generate just the required rate of return will not have residual earnings or we can say that the investment is irrelevant in the creation of value for the shareholders. Consequently, investments provide value only if they (earn) reach above the required return. [74]

A benchmark may be a price-to-book value of 1.0 where forecasted residual earnings are zero or the required rate of return is equal to the forecasted return on book value. It is referred to as a normal P/B ratio.[75]

Everybody who knows this way of valuating investments will be aware of paying too much for future earnings when they are not expected to generate value because the required rate of return is higher than the earning rates of return.

Value of common equity $V_o = B_o + RE_1 / pE + RE_2 / p2E + RE_3 / p3E$[76]

Residual Earnings = Comprehensive earnings – (Required return for equity * Beginning of period book value) $RE = Earn_t – (pE -1) * B_{t-1}$ [77]

[73] Stephen H. Penman. “*Financial Statement Analysis & Security Valuation*”. (2003), p.141
[74] Ibid, p.165
[75] Ibid,p.144
[76] Note: We do not take into account the effect of leverage.
[77] Stephen H. Penman. “*Financial Statement Analysis & Security Valuation*”. (2003), p.141

In addition, we must also take into account the Abnormal Earning Growth method. In this case the concept behind this idea is the Price-Earnings Ratio. Whereas book value was introduced here as a measure of stock of value, earnings is referred to us a measure of the change in value. As we explained above, an investor should not pay for earnings growth that does not add value. In the previous concept we talked about how much one should pay per dollar of book value and now, we mention the idea of how much one should pay per dollar of earnings.

The investor needs a method of the P/E ratio where growth that does not add value is discounted. For instance, the manager who is considering an acquisition requires such a model to ensure that he or she will not pay too much for the earnings which he or she is acquiring. This model will prevent investors of pricing earnings growth that does not add value.[78]

Abnormal Earnings Growth $_t$ = Cum dividend earnings $_t$ – Normal earnings $_t$
Where Cum dividend earnings $_t$ = Earnings $_t$ + (p-1) * dividend $_{t-1}$

Cum dividend earnings is the total earning from an investment but as we said before, we will only pay for earnings growth that is greater than the required return, given that normal earnings are generated because of the growth at the required return.
Normal Earnings t = p Earnings $_{t-1}$[79]

We will talk about the concept of fundamental analysis a little bit more in detail. A share is valued deeming the future payoffs that it is expected to deliver. Thereby everyone must forecast payoffs, if a deep job in valuating shares is required. Fundamental analysis is the method of analyzing information, forecasting payoffs from that information and arriving at that valuation based on those forecast.[80]

[78] Stephen H. Penman. "*Financial Statement Analysis & Security Valuation*". (2003),p. 184-186
[79] Ibid, p. 188
[80] Ibid, p. 74

Fig. 2.3 Fundamental analysis statements

1- Knowing the business
- The products
- The knowledge base
- The competition
- The regulatory constraints

Strategy

2- Analyzing information
- In financial statements
- Outside of financial statements

3- Developing forecast
- Specifying payoffs
- Forecasting payoffs

4- Converting forecast to a valuation

5- Trading on the valuation .

Outsider investor. Compare value with price to buy, sell or hold

Inside investor. Compare value with cost to accept or reject strategy

At the end of the picture it is compared the price of investing and an estimation of the value of an investment. This step is the “investment decision”.

The market price of a stock is the price of investing for an investor outside the firm. If this market price is lower than the valuation the analysis says “buy”. If it is higher, “sell”.

In the steps 1 to 4, the diagram explains how to get the valuation for the investment decision. Forecasting payoffs is the key stage in fundamental analysis but as we mentioned above forecasting can not be accomplished without analyzing the information. The meaningful information will be obtained if one knows her/his business.

Briefly the figure can be summarized as whole process comprised by 5 stages where first of all, a strategy must be carried out after taking in consideration the product, the competition, the regulatory constraints.

This is followed by an analysis of the given information about the business and what it is more important and difficult, how to select the relevant and the irrelevant one because there is a big amount of information to be dealt with, like “hard” or quantitative and vast numbers as earnings, cash flows and sales and in the other hand there is “soft” or qualitative information on consumers tastes, quality of management, technological changes. Thus efficiency is a key term in information for forecasting.

The payoffs that shareholders will receive depend upon the future success of operation like revenues minus expenses (net income) or cash inflows minus cash outflows (net cash flow). In other words, how are revenues and expenses measured? But this is an accounting issue that is very profound. Due to this density we will mention two possible methods as conservative accounting and neutral accounting[81] but we believe that this is not relevant in order to develop our study in the field of developing forecast.

But the next stage tells us that forecasting is not made just for a couple of years. Instead of that, they are made for a stream of future payoffs. But we can not forecast for unlimited years, thus the forecast payoffs are reduced to one number of years, the valuation. But payoffs are uncertain, so expected payoff must be discounted for risk. We have already mentioned above two methods like Residual Earnings and Abnormal Earning Growth.

Finally the investment decision "trading on the valuation" the outside investor decides to invest in a project, to merger or purchase another firm, for instance, by comparing their estimated value to their price. Whereas the inside investor take into account the estimated value of an investment and its cost. We talk about "Value added" in both cases.[82]

After this explanation about what fundamental analysis is, we considerer interesting to talk about what really generates value. Changes in common shareholders´ equity (CSE) can be explained by changes (flows) in net operating assets (NOA) and net financial obligation (NFO). The figure helps us in developing this idea.

Beginning stocks (t-1)	**Flows**	**Ending stocks**
NOA_{t-1}	$OI_t - (C_t - I_t)$	NOA_t
NFO_{t-1}	$NFE_t - (C_t - I_t) + d_t$	NFO_t
$\mathbf{CSE_{t-1}}$	$\mathbf{OI_t - NFE_t - d_t}$	$\mathbf{CSE_t}$
	Earnings	

As we can observe here, free cash flow ($C_t - I_t$) does not add value to shareholders. Free cash flow can be placed as a driver of the net financial position but it is irrelevant in determining the value of the owners´ equity. This is a key concept because the wealth of the shareholders is related to the profits from operating activities (OI) and financing activities (NFE). Thereby we obtain the comprehensive income, earnings or also called the total value added to the shareholders in the income statement.

Therefore, the free cash flow is not a measure of value creation from selling products. It is just a dividend of excess cash from operating activities to the financing ones.[83]

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[81] We are aware of the use of different account methods can modify the profitability ratios in order to compare them between different firms. However this issue has not been taken into account since we consider this not to be relevant enough for the subsequent study of the cases.
[82] Stephen H. Penman. "*Financial Statement Analysis & Security Valuation*". (2003), p.75, 76
[83] Ibid, p.232

We should be aware in not mixing financing with operating flows or financial assets and liabilities with operating assets and liabilities. This separation leads us to different ways in obtaining profitability. We approach this vague concept by developing the next ratios, as measures of profitability[84]:

- Return on net operating assets ($RNOA_t$) = OI_t / ½ (NOA_t + NOA_{t-1})

- Return on net financial assets (RNFA) = NFE_t / ½ (NFA_t + NFA_{t-1})

- Net borrowing cost (NBC_t) = NFE_t / ½ (NFO_t + NFO_{t-1})

<u>Profitability and Growth:</u>

The analysis of profitability and growth, as we said before, involve price-book valuation model and the price-earning model which conduct us to forecast future residual earnings and abnormal earnings growth respectively.

Both Residual earning and earning growth are explained by the profitability of shareholders´ investment, ROCE, and the growth in equity investment. To forecast, it is required to know what drives ROCE and what drives growth in profitability analysis and growth analysis respectively. Sometimes profitability drivers will be referred to as value drivers.[85]

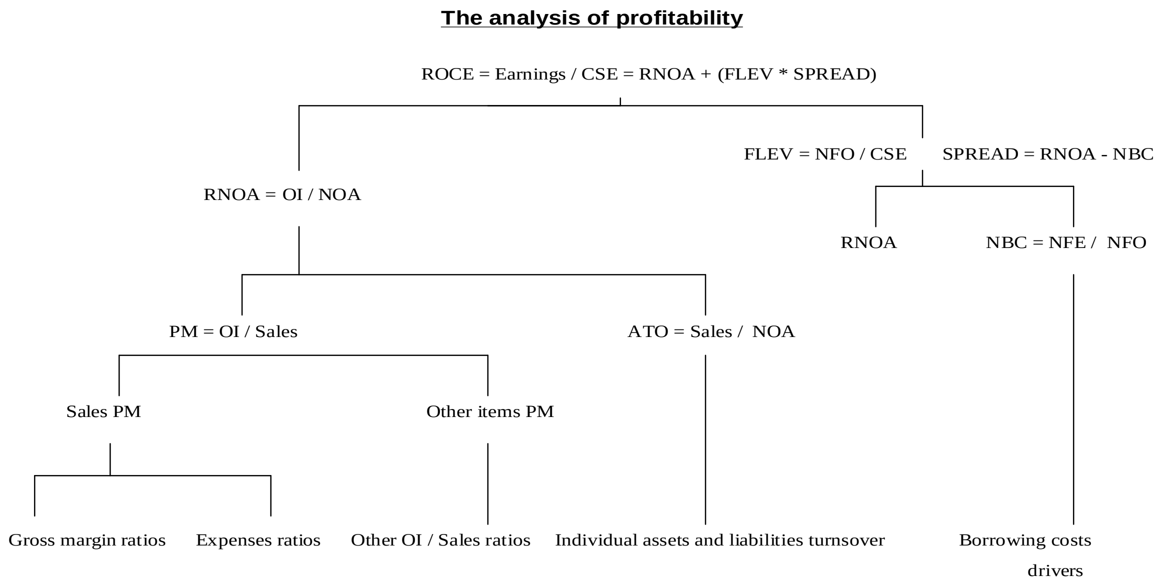
Thus, profitability analysis is considered a tool for strategy analysis, decision making and valuation. The main question is to figure out how the profitability will change as a result of a particular decision and if that change generates value for shareholders. What will be the effect of an acquisition of another firm?

Throughout this analysis of profitability we will get some answers but we will try to summarize this issue as much as possible to make this study easier to read. The next figure provides a good model of how some changes in operational and financing activities becomes in changes of ROCE or shareholders profitability.

According to the figure, the value is generated by economics factors. It is important to know the business to understand which factors will determine value creation. We will explain this by breaking down the return on common equity:[86]

[84] Stephen H. Penman. "*Financial Statement Analysis & Security Valuation*". (2003), p.233
[85] Ibid, p.349
[86] Ibid, p.349

Fig 2.4 The analysis of profitability



Source: Stephen H. Penman.Financial Statement Analysis & Security Valuation

<u>Final statement line items</u>:

Earning = comprehensive income
CSE = Common shareholders´ equity
OI = Operating income (after tax)
NOA = Net operating assets
NFE = Net financial expense
NFO = Net financial obligations

<u>Ratios:</u>

ROCE = Return common equity
RNOA = Return on net operating assets
NBC = Net borrowing cost
FLEV = Financial leverage
SPREAD = Operating Spread
PM = Operating profit margin
ATO = Assets turnovers

ROCE = Comprehensive earnings / Average CSE

ROCE = OI –NFE / NOA – NFO

ROCE = (NOA / CSE)* (RNOA) – (NFO / CSE) * (NBC)

Where RNOA = OI / NOA and NBC = NFE / NFO

ROCE = RNOA + {NFO/CSE) * (RNOA – NBC)}

Thus, ROCE = RNOA + (Financial Leverage * Operating Spread) and,

ROCE = RNOA + (FLEV * SPREAD)

Thereby we come up with the drivers of ROCE. The first breakdown distinguishes the profitability of both operating activities and financing ones. It is important to mention how financial leverage and the spread behave, because it makes the ROCE to decrease or increase depending on the amount of the leverage and the sign of the spread respectively.

Financial leverage is a measure that explains how much operating assets are financed by net financial obligations or by common equity. If the return from operation (RNOA) is bigger than the borrowing cost the spread will be positive and therefore ROCE will increase.[87]

In the next breakdown, RNOA is broken down into its drivers as:[88]

ROCE = RNOA + {FLEV * (RNOA – NBC)}

ROCE = (PM * ATO) + {FLEV * (RNOA – NBC)}

When operating profit margin PM = OI (after taxes) / Sales and it means the profitability of each dollar of sales.
In the other hand, assets turnovers ATO = Sales / NOA and it explains the sales revenues per dollar of net operating assets invested or how Sales are generated per unit of NOA and it is sometimes referred to as 1 / ATO = NOA / Sales, which reveals how much NOA is required to generate a dollar of sales.

This second breakdown is referred to as the Du Pont Model, which explains us that RNOA is greater when the amount of OI is larger per dollar of sales, which is a profitability measure. RNOA also increases if the firm generates more sales for a level of NOA invested, which is an efficiency measure.

Thereby, a profitable firm will have the chance of increasing margins by using operating assets and operating liabilities efficiently to produce sales. Many sources indicate that industries with high profit margins are use to having low asset turnovers and vice versa.[89]

Different industries like telecommunications have normally low turnovers and high margins. However food stores can reach high turnovers because they can sell according to the square foot or space which is a way of NOA. We also notice that competition reduces margins.

The profit margin drivers are as follow:

PM = Sales PM + Other items PM and if we break it down deeper we will obtain:[90]

Sales PM = Gross margin ratio – Expense ratios

[87] Stephen H. Penman. "*Financial Statement Analysis & Security Valuation*". (2003), p.351
[88] Ibid, p.360
[89] Ibid, p. 360
[90] Ibid, p.362

Sales PM = Gross margin / Sales – Administrative expense / sales – selling expense / Sales – R&D/ Sales – Operating taxes / Sales

It is also possible to break down the turnover drivers into ratios for individual assets and liabilities: [91]

1 / ATO = Cash / Sales + Accounts receivable / Sales + Inventory / Sales + …+ PPE / Sales + Accounts payables / Sales – Pension obligation / Sales - …
PPE refers to as Property, plant and Equipment.

We tried throughout this theoretical overview to organize and to help the carefully reader with some concepts which can provide a better understanding in other parts of our study related to the effects of business activities on value. Thereby, it will be easier to understand how a change in the profit margin or assets turnovers affects residual earnings and ROCE.[92]

After the profitability analysis, we want to approach what growth means. As we mentioned before firms can increase its earnings without adding value. Thus, the investor must be aware of paying too much for earning growth because it is not a valid concept for valuation. Instead of this they should consider the residual earning growth and the abnormal earnings growth as the key measures.[93]

Growth is a wide concept where it can be broken down in three kinds: growth in sales, in earnings or in assets. But we agree when growth is considered as positive factor in order to create value.

Once again, growth will be observed from the residual earning and the abnormal earning growth methods, which explain that "a growth firm is one that can grow residual earnings and one will pay more than a normal P/E based on the ability to generate abnormal earning growth"[94]and we will remind that "abnormal earning growth is equal to the change in residual earnings". According to professor Penman, *"a firm with zero abnormal earning growth has no growth in residual earnings."*

2.14 How to valuate a company?[95]

Valuation of companies is one of the most important steps in the process of merger and acquisitions. As we have seen before, some of the reasons that explain the failure of M&A are the incorrect valuation of the company and the synergies. There are different ways of valuating a company. The most important are the next:

[91] Stephen H. Penman. "*Financial Statement Analysis & Security Valuation*". (2003), p.362
[92] Ibid, p.368
[93] Ibid, p.382
[94] Ibid, p.384
[95] Bernard Jaquier, Professor of Economics & Finance, "*Corporate Finance Course*" , Ecole Hôtelière de Lausanne, 2003

- Multiple of profits method:

For quoted company

- Method based on PER (Price Earnings Ratio)

Value of the company = Market Value of Equity + Market Value of Debts

Market Value of Equity = [PER * PAT]

Where PAT = Profit After Tax. And PER = [P / EPS]

This method has some limitations. It estimates the post-acquisition earnings for the target company in a single period, and supposes that this level will be kept in the future. Furthermore, the method does not consider the investor-perceived risk of the acquired company's earnings.[96]

- Method based on market capitalization

Market Value of the company = Market Value of Equity + Market Value of Debts

Market Value of Equity = [P * N]

Where P = Market value per share and N = Number of shares.

Non-quoted company

The first step in the valuation of a non-quoted company is to find a similar quoted company and use the PER of this company. This PER has to be adjusted since the unquoted company may have a higher risk and worse prospects (the common discount is between 25 and 40 per cent).
The next step is to determine the sustainable profit after tax (PAT) of the unquoted company.

The last step is to multiply the PER and the PAT.

- Discounted cash flow

This is the most used method. According to this method, the value of a company is represented by the present value of the expected cash flows. The steps on the calculation of the discounted cash flows are the next:

- Determinate the time period that is expected to generate these cash flows. It is usually the period when is expected to keep the company's competitive advantage.

- Estimate the free cash flows, which are the amount of cash generated before financing.

[96] P.S. Sudarsanam, *"The Essence of Merger and Acquisitions"* (1995), p.148

Free cash flows (FCF) = Operating profit – Taxes + Depreciation – Capex +/– Change in working capital

Capex refers to the amount of money spent to acquire physical assets.

- Estimate the terminal value, which is the expected amount of money that the company is expected to be worth at the end of this period.

- Determine a discount rate (WACC) for the investment.

WACC = (D / D + E) (Kd) * (1-t) + (E / D + E) (Ke)[97]

D: Debt; E: Equity; Kd: Cost of Debt; Ke: Cost of Equity; t: Taxes

- Discount the cash flows at the WACC

- Add the value of non-operating assets

- Deduct the current quantity of debt from the company value

We have to add that many times a premium is paid for the control of the company. The premium is usually a 30 per cent of the total value of the company.

The following are some of most typical mistakes. They could be avoided just taking into account some rules like[98]:

- Do not ignore market values. Sometimes it is difficult to obtain values by using discounted cash flows (DCF)
- The use of the correct discount rate because a firm could discount cash flows with its own cost of capital instead of using the one that reflects the risk related to the use of funds.
- Estimate just incremental cash flows because many investors could invest in projects or in acquisitions which will bring more cash flows but will decrease the wealth of the shareholders due to a decrease in the book value. It is important to take in consideration the cash flows from projects that will involve higher returns than the cost of capital of the firm. We developed this idea in the prior chapter when we explained what residual earnings and abnormal earnings growth were.

2.15 How to pay for the acquisition, cash versus stock trade-offs[99]

There are two ways of paying for a transaction, cash and stocks. The main difference between them is that in cash transactions, shareholders of the acquiring company take all the risk that the expected synergy value inside the premium will not be materialized. In a stock transaction, shareholders of the acquired company share that risk. Stock financed transactions are common in large acquisitions since the risk of not achieving the synergies is really big.

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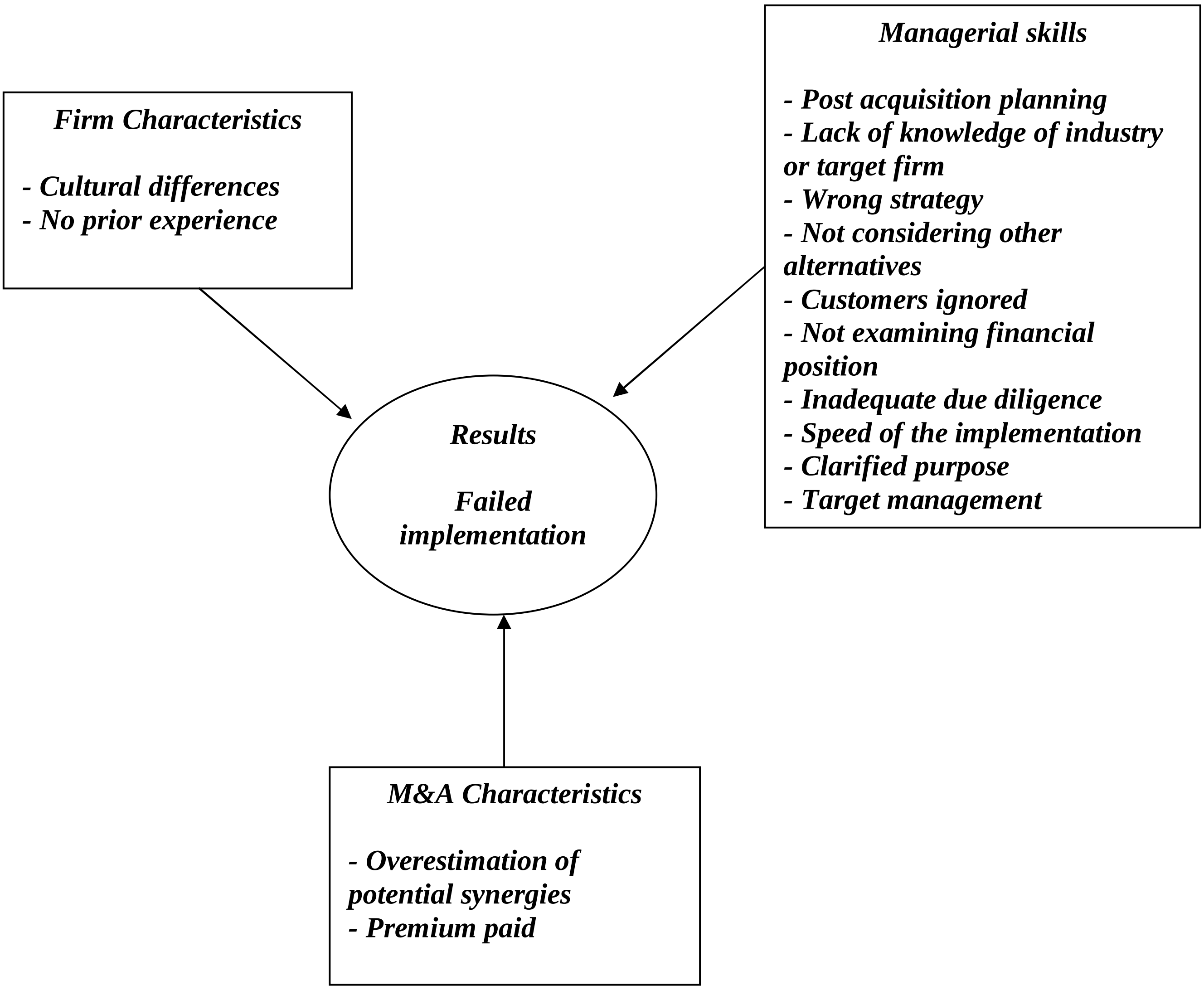
[97] Alan C. Shapiro, *"Multinational Financial Management"* (2006), p. 489
[98] Ross/Westerfield/Jaffe "Corporate Finance"(2005), p. 808
[99] Harvard business school press, *"Harvard Business Review on Merger and Acquisitions"* (2001), p.51

2.16 Integrative model of the factors influencing the success or the failure of a M&A[100]

The next model represents a summary of the theory in order to present it in a more clear way.

Fig 2.5 Integrative model



[100] Vassilis M. Papadakis, *"The Role of Broader Context and the Communication Program in Merger and Acquisition Implementation Success"*, p. 7

2.17 Formulation of propositions[101]

After analysing in depth the existing theory, we are able to formulate the propositions that will be discussed in the next part. We have decided to formulate more that one proposition since there are a lot of motives for the success or failure of a merger or acquisition.

Proposition 1: Less cultural differences will be positively associated to successful implementation.

Proposition 2: No post acquisition planning will be negatively associated to successful implementation.

Proposition 3: Lack of knowledge of industry or target firm will be negatively associated to successful implementation.

Proposition 4: No prior acquisition experience will be negatively associated to successful implementation.

Proposition 5: Following a wrong strategy will be negatively associated to successful implementation.

Proposition 6: Not considering other alternatives to merger or acquisitions will be negatively associated to successful implementation.

Proposition 7: Overestimation of potential synergies is related to less successful implemented M&A.

Proposition 8: Higher premiums are related to less successfully implemented M&A

Proposition 9: Wrong management of the integration is related to less successfully implemented M&A.

Proposition 10: Ignoring customers during the integration will lead to less successfully implemented M&A

Proposition 11: Not examining the financial position of the acquired company will lead to less successfully implemented M&A.

Proposition 12: Incomplete or inadequate due diligence will lead to less successfully implemented M&A.

Proposition 13: Implementations made quickly will be associated to successful implementation.

Proposition 14: Clarity of acquisition purpose will be associated to successful implementation.

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[101] Vassilis M. Papadakis, *"The Role of Broader Context and the Communication Program in Merger and Acquisition Implementation Success"*, p. 7

Proposition 15: High degree of target management co-operation will lead to successfully implemented M&A.

3. SCIENTIFIC APPROACH AND RESEARCH DESIGN

The aim of this part is to explain the research design we have decided to follow, and explain why we have decided to choose it.

3.1 Why did we choose this topic?

During the prior months before starting our study, Spanish media were focusing on the possible acquisition of Endesa by E.ON. This acquisition never happened due to the interests of the Governments and other political interests.[102]

This was not the only transaction that has taken place in Spain in the last years. Spain has become the third biggest M&A market in the world. Due to this fact, the job opportunities in this area are increasing year by year. We believed that due to our study our skills within this topic would increase, and consequently, our possibilities for finding a future job in this area.[103]

We also selected this topic because as students in finance, we thought that the reasons for the failure of most of the mergers and acquisitions were financial ones.

3.2 Deductive theory

We will follow a deductive way of conducting our study. It means that we will study the existing theory (explained in the second part) to create our own propositions extracted from the theory that will be discussed through the empirical study. The process that we are developing will be explained in the next figure:[104]

2.6 Fig. Deductive model

1. Theory (Part 2)

↓

2. Propositions (Part 2)

↓

3. Data collection (Part 4)

↓

4. Findings (Part 4)

↓

5. Proposition confirmed or rejected (Part 4)

↓

6. Revision of theory (Part 5)

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[102] New Europe "*the European weekly*" April, 14th 2007, Number 724, p. 20
[103] Ibid, p. 20
[104] Bryman, Alan & Bell, Emma, "*Business research methods*", (2003), p.11

3.3 Research design

After explaining what the arguments given by the different authors for the failure of the mergers and acquisitions are, our objective will be to subject the existing theory to an empirical study.

- The purpose of our comparative design is to compare some successful transactions with other failing transaction. We will study two cases of successful mergers (Telia Sonera and Stora Enso), one case of failing merger (Telia Telenor), one case of successful acquisition (BP Amoco) and one case of failure acquisition (Quaker Snapple). After reading many studies made about this topic, we have found that this is a method that has been used hardly ever, and we expect that, due to this fact, we will find some new conclusions.

- Throughout the theoretical background, we have used some quantitative analysis made by other authors. Once we have approached the existing theory, we have developed the concepts deeply, which involves the use of a qualitative research methodology apart from the quantitative one.

- Data collection: The method we will follow for the collection of the data is the study of archival information. Due to the impossibility of conducting an ethnographic research or interview relevant people within the companies, we have concluded that the best research method for studying the cases is studying the information available in the different literature. Since all the cases we will study are important cross-border transactions, we believe that the information available in the different literature will be enough for the purpose of our study.

In order to collect data, we have used a great variety of books, scientific articles and internet sources. We did our best in finding unbiased information and as updated as possible. Scientific articles have been sought using the Umea University´s databases and the books come from the University´s library.

- Research philosophy: During the study, we wanted to adopt exclusively a positivism point of view. This involves that the purpose of the theory is to generate propositions in order to be discussed, related with the principle of deductivism. In the other hand, knowledge is gathered of facts that provide the basis for the laws. Finally, this epistemological approach concludes that the principle of objectiveness is key.[105]

However, due to the nature of this topic, we think that it must not be appropriated to adopt a positivistic view exclusively. Studying a topic related to management of people and organizations implies the need of being more flexible, and consequently, adopt an interpretivism view apart from the positivism one. Our study could have a lack of objectivity since we will analyse the archival information in order to look for explanation why M&A fail.

- Ontological orientation: We have adopted a constructionism ontological orientation because we have presented a specific version of social reality, rather than a

[105] Bryman, Alan & Bell, Emma, "*Business research methods*", (2003), p.14

definitive one.[106]In further studies we will see how the social phenomena are in constant state of revision.

- In respect to the sample, the method that we are going to select in the different cases (success and failure cases) will be the opportunistic one. We will select international mergers and acquisitions, since the existing data for these cases are much bigger.

3.4 Main preoccupations as researchers[107]

We will have some concerns throughout the research. Our main preoccupations will be:

- Reliability: *"It is concerned with the question of whether the results of a study are repeatable".*[108] The result of this study is repeatable because the quantitative surveys that we have employed in the theoretical part use measurements that are stable. We carefully collected data with the main sources. This issue is also important to achieve a high validity.

- Replicability: We have explained all our procedures in detail in order our study to be replicable. It is consistent with our study since all data we have used is correctly referenced and could be obtained again following the same research method. One of the reasons for not conducting an ethnographic study or interviews is that the replicability of the study could be affected seriously since the environment could change.

- Validity: Our study has a lack of external validity in some of the parts, especially during the comparative design. Due to the fact that we have only studied five cases, the findings of those cases are difficult to generalize. According to the external validity and the concept of transferability, we think that the findings can not be extrapolated to other firms because our study is not big enough.

We have put especial efforts in the credibility of the sources because the internal credibility depends on them.

We introduced before our attempt to follow a positivism point of view although we are aware of the difficulties of being objective all over this study. This is connected to the concept of "confirmability", which is related to objectivity, mentioned above.

3.5 Limits of our study[109]

We want to point out some limitations that can come out due to the selected research method.

First of all, we would like to say that, due to the fact that we will study previously written information, our study may have a lack of originality. However, the objective of most of these articles previously written is not the same as our goal. This is why we believe that we are motivated enough to provide some useful information. Furthermore,

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[106] Bryman, Alan & Bell, Emma, *"Business research methods"*, (2003), p.20
[107] Ibid, p.293
[108] Ibid, p.33
[109] Ibid, p.298

the comparison between the different cases is something that has hardly ever been done, and will provide some new important knowledge to the existing knowledge.

In addition to this, our study will be difficult to generalize. Due to the fact that we will focus only on the study of some cases, is going to be difficult to generalize to other cases. During the theoretical part, we have presented the results of some quantitative researches because we knew that our findings would be difficult to generalize. We are also aware about the impossibility of finding all the information we need. However, the fact that we have selected leader companies in representative markets make our study a little bit more generalizable.

We would like to warn the careful reader that in the subsequent parts of the study different indicators to measure operating income will be used. This limitation is noted in order not to get the readers confused when comparing data in the following case studies. Moreover, data are not always extracted from the same sources, thus sometimes data can not be compared each other, even though the main idea is accomplished. For instance, some definitions and concepts changed in January 1st, 2003 in Telia´s reports. The former definition of EBITDA included operating income before depreciation, amortization and write-downs was transformed to operating income before depreciation, amortization and before income from associated companies. Thereby, underlying EBITDA was denominated EBITDA excluding non-recurring items. Thus, a new way of measuring profitability was adopted.[110]

Managers consider these measures as ones usually reported and widely used by analysts and investors. Thus, these measures are suitable in order to understand historical operating performance. However, EBITDA excluding non-recurring should not be consider a measure of liquidity. Moreover, this indicator is not included under US GAAP (General Accepted Accounting Principles).[111]

Finally we would like to say that due to the lack of information in some of the points, the structure of the different cases might be different.

[110] http://www.teliasonera.se/ April 25, 2007
[111] http://www.teliasonera.se/ April 25, 2007

4. CASE STUDIES: STORA ENSO, QUAKER SNAPPLES, BP AMOCO AND TELIA SONERA.

Throughout this part we are going to present the different data we have collected, the findings and the confirmation or rejection of the existing theory.

4.1 Stora Enso

4.1.1 Introduction to the forestry industry

The forestry industry is formed by a group of relatively mature large-scale lines of business that are becoming more global during the last 20 centuries. The forest industry has been one of the fastest growing businesses. While in the beginning of the 20th century, less than ten million tons of paper were produced, in 1950, 43 million tons were produced, growing to 260 million tons in 1995, which represents an annual four per cent growth in the last century. The fastest growth has occurred during the period 1990-2003, which sales represent the 61 per cent of the sales in the post-war era.[112]

Although North American companies have leaded the market historically, Nordic companies have caught up the distance. Almost one-third of the world production comes from Nordic companies. The reasons for this increase are: large investments in new production and technologies, a process of consolidation, the increase in the importance of forestry clusters in the national economies of the Nordic countries, and the faster growth of the demand in Europe.[113]

Despite this growth of sales during the last century, the forest industry sector has experienced a period of diminishing returns due to a lack of productivity.

During the 20th century, most of the companies were family owned. With the beginning of the new century, a process of consolidation took place, but still family owned companies have a great importance inside the sector, specially in those niches of the market that require constant innovation and operational consistency. Most of the paper firms were founded during the industrialisation, developing domestically through organic growth, mergers and acquisitions, and finally they experienced a period of internationalisation during the globalization era.[114]

Maximization of the shareholder value was not a main objective between Nordic companies until the early 1990s. Profitability was neither the main matter until this decade, when the ownership structure of the firms started to change.[115]

[112] Jari Ojala, Anders Melander and Juha-Antti Lamberg,*"Competitive Behaviour & Business Innovation in the Forest Industry: Family Firms, Listed Companies and Cooperatives compare"* (2006), p5
[113] Ibid
[114] Ibid, p.6
[115] Ibid, p.6

4.1.2 Merger background

Introduction to Stora[116]

Stora Koppabergs Bergslags Aktiebolag (Stora) started its activity in Falun, central Sweden, about one thousand years ago. The initial business was cooper mining, which was substituted by iron mining in the 18th century.

In 1862, the operations were combined into a single company named Stora Koppabergs Bergslags Aktiebolag, which became a limited company in 1888. The activities of the former companies were sawmilling, energy, pulp paper, iron and steel production.

In 1978, Stora sold its iron and steel businesses and focused on energy and forestry industry. The expansion continued in the next two decades and in 1998 it merged with the Finnish company Enso Oyj.

Introduction to Enso[117]

Enso Oyj started as a sawmill firm at Kotka, south of Finland in 1872. It was built by the Norwegian firm W. Gutzeit & Comp.

The Finnish government acquired the company in 1919, after acquiring the company Enso Träslipieri Aktiebolag in 1912, starting the production of paper. The name was changed to Enso-Gutzeit Osakeythiö in 1928.

During the Second World War, the company suffered severely, but after a heavy rebuilding programme it became one of the leading companies in Finland. In the 1960s, the company started a process of internationalization, which leaded to the merger with the Swedish company Stora Koppabergs Bergslags Aktiebolag, forming Stora Enso Oyj, one of the leading forest product companies in the world.

Introduction to Stora Enso[118]

Stora Enso Oyj is a company formed by 46,665 employers, and is incorporated under the laws of Finland. The company is divided into six global divisions, which are publication paper, fine paper, merchants, packaging boards, wood products and wood supply[119]. The principal markets for the company are Western Europe and Northern America, were it acquired the company Consolidated Papers Inc. in the year 2000.

After the merger between both companies, the company held the second position in magazine papers, newsprint, consumer packaging board, and the third position in fine paper in the world.

The Company has an annual production capacity of 16.5 million tons of paper and board and 7.4 million cubic meters of sawn wood products.[120]

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116 www.storaenso.com, April 23, 2007.
117 www.storaenso.com , April 23, 2007
118 http://www.answers.com/topic/stora-enso-oyj-adr, April 23, 2007
119 http://www.nyse.com/about/listed/seo.html, April 24, 2007
120 http://www.nyse.com/about/listed/seo.html, April 24, 2007

The strategic goals of Stora Enso are *"to increase the company's value through a profitable growth and reducing the earning volatility"*. Into this strategy can be included the merger between both companies. The last year, Stora Enso is focusing its growth in the South American, Russian and Chinese markets.

The main shareholders of the company are the Finnish state and the Swedish Investment group AB, with 24.1 per cent of the voting rights each.

4.1.3 Transaction

Characteristics of the operation

The merger was implemented by a public offering from Enso for all shares of Stora against newly issued shares in Enso. The transaction was designated as a merger of equals.[121] Stora became a wholly owned subsidiary of Enso.[122]

Purpose of the transaction

According to Teresa A. Daniel and Gary S. Metcalf, in their book *"The Management of People in Mergers & Acquisitions"*, the main reason for merger or acquire another company is that is the fastest way of growing in sales and in can represent a way of improving the profitability.[123]

The pulp and paper industry is represented by high capital intensity and a fragmented structure. Due to these facts, the sector of paper experiences cyclical prices and earnings throughout the years. The biggest need of the industry is to improve the overall profitability level in order to achieve higher overall returns to the shareholders. [124]

The merger between Stora and Enso took place in order to achieve a higher level of profitability. This objective would be achieved as a result of improving the long term utilization of the production capacity.[125] The merger was seen as an opportunity to grow in the results and creating synergies.

These synergies between both companies would be obtained due to the fact that both companies had similar structures and through this merger could be able to rationalize the operations and become more efficient.[126]

According to Björn Hägglund, deputy CEO of Stora Enso, *"cost reductions, market power, acquiring resources and managerial motives were al sub-motives*".[127]

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[121] http://boxboard.com/ar/boxboard_stora_enso_agree/, April23, 2007
[122] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31999D0641:EN:HTML, April 24th, 2007
[123] Teresa A. Daniel and Gary S. Metcalf, *"The Management of People in Mergers & Acquisitions"*, p.10
[124] http://boxboard.com/ar/boxboard_stora_enso_agree/, April 23, 2007
[125] http://boxboard.com/ar/boxboard_stora_enso_agree/, April 23, 2007
[126] Kristina Ahlström and Tina Nilsson, *"Success in International Mergers"*, p. 59
[127] Ibid

Expected results

The expected synergies to be obtained were EUR300 million. The first year, the expected synergies were EUR50 million, the second year EUR170 million and the third year EUR80 million.

Real results. Was the merger a success?[128]

The real synergies in the year 1999, amounted EUR113 million, which was much higher than what was expected before. These synergies were bigger in magazine paper, fine paper and timber products. The savings achieved due to the productivity programme summed EUR30 million. The market share was kept as it was before the merger.

During the year 2000, the synergies were EUR240 million. The savings achieved due to the productivity programme were EUR75 million:

The biggest sources of synergies were purchasing and logistics, internal benchmarking, sales and administration and production streamlining. Purchasing synergies represented the 50 per cent of the total synergies in the year 1999, and the 23 per cent in 2000. Sales and administration represented 23 per cent in 1999 and 21 per cent in 2000. Finally, production streamlining represented a 17 per cent in 1999, and a 46 per cent in 2000.

Another measure of the success is the fact that two years and a half after the merger, 98 per cent of the 200 top employees in leadership positions remained in the company.

The key ratios show that the merger was a success, since all of them were improved throughout the first year:

Table 4.1 Key ratios

Key Ratios	**31 Dec. 1998**	**31 Dec. 1999**	**31 Dec. 2000**
Equity per share, EUR	6.93	7.84	9.4
Return on capital employed (ROCE), %	6.2	13.1	20.7
Return on equity (ROE), %	3.4	12.9	19.5
Debt/equity ratio	1.05	0.78	0.59
Average number of employees	40,987	40,226	41,785
Operating profit, %	6.9	13.3	18.2
Capital expenditure EUR million	896	740	769
Capital expenditure % of sales	8.5	7.0	5.9
Capital employed at end of period	11,365	10941	13903
Interest-bearing net liabilities	5,820	4783	5183

[128] www.storaenso.com, April 25, 2007. Press release 1999 and 2000

Table 4.2 Condensed Consolidated Income Statement (IAS)

Condensed Consolidated Income Statement (IAS)

EUR million	**Full year 1999**	Full year 1998
Sales	**10,635.7**	10,489.6
Expenses and other operating income	**-6,580.4**	-6,824.3
Personnel expenses	**-1,754.3**	-1,805.2
Depreciation and value adjustments	**-892.6**	-1,151.4
Share of profits of associated companies	**9.7**	9.9
Operating profit	**1,418.1**	718.6
Financing	**-266.6**	-379.2
Profit before taxes and minority interests	**1,151.5**	339.4
Taxes	**-394.5**	-148.2
Profit after taxes	**757.0**	191.2
Minority interests	**-4.5**	-0.2
Profit for the period	**752.5**	191.0
Earnings per share, EUR	**0.99**	0.25
Earnings per share diluted, EUR	**0.99**	0.25

Finally, during the first year after the merger, the company hardly lost any customer. Since the objectives considered before the merger were achieved, and in some cases improved, we can just say that the merger was a success.

Why was the merger a success?

- Proposition 1: Less cultural differences will be positively associated to successful implementation.

As we pointed out throughout the theoretical background part, cultural differences are the most common reasons for failure.

In the case of Stora and Enso, historically, there was not a unique organizational culture previous to the merger. However, after the merger, the intention of the former company was to create an organizational culture by taking the best parts of each culture.[129]

Before the merger, managers of both companies were seriously concerned about the possibility of having some problems due to the difficulty of fitting the cultures of both companies. The main differences between both companies were a consequence of their different nationalities. In Finland, less time is expended in planning, and this fact brought some problems that were not so important.

[129] Anna Grankvist, Carolina Kollberg, Anna Persson, *"Implementation of Organizational Culture Following a Merger"*, p.51

The factors that contributed to a successful culture fit were the next:[130]

> - Desirability of the transaction: Due to the fact that the merger was supported by Stora and Enso, the cultural fit and the integration process was much easier to complete. This would be much more difficult in the case of a hostile acquisition.
> - Mutual respect before the transaction: Although both companies were competing in the same markets, they have had a history of mutual respect that made the integration process easier.
> - Celebrating of early benefits: This was a motivating fact for employees and contributed to the successful culture fit.

- Proposition 2: No post acquisition planning will be negatively associated to successful implementation.

The integration planning started as soon as the companies decided to merge. The objective of this integration plan was to create the best company possible. Stora and Enso created an integration team that was responsible of this integration process. The team was formed by Björn Hägglund, CEO of Stora, who was the chairman. The other members of the team were an equal number of top managers from both companies.[131]

Inside this team, all the departments from both companies were represented, but the Human Resources department was the one who held the most important position. The employees from both companies were prepared for the merger as soon as this integration plan started, and there were some integration seminars in order to achieve this objective.[132]

The main objectives of this integration team were to create common strategies, clarifying the goals of the new company and deciding which of the sales units from the former companies would remain.[133]

The drivers of this integration were a common mission, vision and values. After the new mission, vision and values were created; they were communicated to the 150 top managers of the company that were responsible for communicating to their own department.[134]

- Proposition 3: Lack of knowledge of industry or target firm will be negatively associated to successful implementation.

In the case of Stora and Enso, both companies operated in the same industry, they were similar and they knew each other because they had been competing for a long time. This made easier to achieve the expected synergies and was one of the reasons for making the integration process easier.[135]

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[130] Kristina Ahlström and Tina Nilsson, "*Success in International Mergers*", p. 59
[131] Ibid, p. 47
[132] Ibid, p. 48
[133] Anna Grankvist, Carolina Kollberg, Anna Persson, "*Implementation of Organizational Culture Following a Merger*", p.57
[134] Ibid
[135] Kristina Ahlström and Tina Nilsson, "*Success in International Mergers*", p. 47

- Proposition 4: No prior acquisition experience will be negatively associated to successful implementation.

Between the years 1988 and 1998, Enso merged with five large companies and Stora acquired a number of small companies. This helped both companies to gain knowledge for the posterior integration of both companies.[136]

- Proposition 5: Following a wrong strategy will be negatively associated to successful implementation.

The strategy of both companies was clear before the merger. Both companies considered that the candidates for a merger should fit strategically from a competitive point of view.[137]

- Proposition 6: Not considering other alternatives to merger or acquisitions will be negatively associated to successful implementation.

- Proposition 7: Overestimation of potential synergies is related to less successful implemented M&A.

As we have pointed out before, the real synergies were much higher than the expected synergies. One of the main objectives of the merger was to create synergies as a consequence of the integration of both companies.

Although the real synergies were much higher than the expected ones, we have not found any information to explain if this was a critical factor for the success of the implementation of the merger, but it was one of the consequences of the successful implementation of it.

- Proposition 8: Higher premiums are related to less successfully implemented M&A.

- Proposition 9: Wrong management of the integration is related to less successfully implemented M&A.

As we have pointed out throughout the explanation of the proposition 2, an integration team was created in order to success in the integration of both companies.

- Proposition 10: Ignoring customers during the integration will lead to less successfully implemented M&A

During the explanation of the real results of the merger we said that the company did not lose market share and was able to keep almost all its customers.

- Proposition 11: Not examining the financial position of the acquired company will lead to less successfully implemented M&A.

[136] www.storaenso.com, April 26, 2007
[137] Kristina Ahlström and Tina Nilsson, "*Success in International Mergers*", p. 47

- Proposition 12: Incomplete or inadequate due diligence will lead to less successfully implemented M&A.

A due diligence was made by two companies in order to identify the perfect candidate for the merger, establishing the integration team and making the post acquisition plan.[138]

- Proposition 13: Implementations made quickly will be associated to successful implementation.

The intention of the company was to be able to be well-functioning just the day after the approval. The main worry for the company was to explain to its customers that the products they were buying belonged to Stora Enso, and they succeeded doing this. The implementation process was completed just two months after the European Union approved the merger.[139]

- Proposition 14: Clarity of acquisition purpose will be associated to successful implementation.

According to Stora Enso, *"a merger or acquisition must support the core business, provide synergies for production and customers, improve asset quality and competitiveness, and be in concordance with the attitude of the market"*. [140]

In the case of the merger between Stora and Enso, the purpose of the merger was really clear since the beginning. As we pointed out before, the merger between Stora and Enso took place in order to achieve a higher level of profitability.

Apart of this main purpose, the management of Stora Enso developed short-term goals. According to these short-term goals, each Swedish divisional manager should work together with her/his Finnish counterpart, in order to set up strategies for the new division of the future company.[141]

- Proposition 15: High degree of target management co-operation will lead to successfully implemented M&A.

Since the first moment after the merger was announced, Stora Enso's target was to quickly involve the managers in the management of the new company. New joint leadership policies, concerning what a good leader was, were established together, and were implemented on both middle management and senior management levels.[142]

Before the merger, an investigation amongst the managers of both companies was made in order to establish an integration plan. The communication inside the companies was improved in order to avoid possible resistances to the change, and training and

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[138] Anna Grankvist, Carolina Kollberg, Anna Persson, *"Implementation of Organizational Culture Following a Merger"*, p.57
[139] Kristina Ahlström and Tina Nilsson, *"Success in International Mergers"*, p. 49
[140] www.storaenso.com, April 26, 2007
[141] Anna Grankvist, Carolina Kollberg, Anna Persson, *"Implementation of Organizational Culture Following a Merger"*, p.58
[142] Ibid, p.52

development programs were provided for the managers.[143] The 100 highest managers from both companies formulated the mission, vision and values of the new company in an early stage, consequently the managers will know how to act in the new company in the subsequent periods.

After the merger, Stora Enso celebrated annual meetings for the 200-300 top managers in order to improve the communication between them and to get them involved in the new organization. [144]

New facts founded for the success of the merger between Stora Enso

In this section we want to present some facts that were really important for the success of the merger which were not previously contemplated in the theory review:

- Stora Enso took special care on monitoring the progress of the integration process. Interviews and questionnaires were regularly made to the employees (in special top managers) in order to investigate how the integration process was going. The main goal was to verify if the communication of the new mission, vision and values were being transmitted properly.[145]

- Importance of the mission, vision and values for the unification of the company: As we have pointed out in during the discussion of the propositions section, mission, vision and values were established since the first moment because they were considered as one of the most critical factors for the integration of both companies. The fact that this mission, vision and values were created by the managers from both companies working together contributed to this integration process.

Negative aspects[146]

- Problems with the unions. 2,000 jobs were cut during the period 1999-2002. When the agreement was announced, 500 jobs were expected to be cut in administrative and marketing positions in particular. Due to this fact, employees and trade unions in Sweden and Finland, who initially reacted positively to the merger, showed their concerns and affected negatively to the employees satisfaction. The market reaction to this announcement was just the opposite, rising the share price.

- Workers representation on board of Stora Enso.[147]According to the Swedish legislation, workers from a group of companies are able to have a representation on the board of directors of the parent company. The problem was that after the merger, the new company was registered under the Finnish legislation, which does not guarantee the representation of workers on the board of directors.
The Swedish Paper Worker's Union and the Finnish Paper Worker's Union claimed for this representation, but the Swedish owned Investor did not agree.

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[143]Anna Grankvist, Carolina Kollberg, Anna Persson, *"Implementation of Organizational Culture Following a Merger"*, p.56
[144] Anna Grankvist, Carolina Kollberg, Anna Persson, *"Implementation of Organizational Culture Following a Merger"*, p.57
[145] Ibid, p.59
[146] http://www.eurofound.europa.eu/eiro/1999/02/inbrief/fi9902195n.html, April 23, 2007
[147] http://www.eurofound.europa.eu/eiro/1999/04/inbrief/se9904157n.html, April 23, 2007

Does this case correspond with the existing theory?

We are going to check if the case of Stora Enso corresponds with the existing theory. We want to point out that, even though some findings of this case might contradict the existing theory, due to the impossibility of generalizing, we can not conclude that the theory is wrong. In spite of that, we consider that these findings should be taken into account by those companies that are involved in a merger or acquisition process.

Table 4.3 Proposition compared to the theory. Stora Enso

Existing Theory	**It corresponds with the theory**
-Less cultural differences will be positively associated to successful implementation.	YES
-No post acquisition planning will be negatively associated to successful implementation.	YES
-Lack of knowledge of industry or target firm will be negatively associated to successful implementation.	YES
-No prior acquisition experience will be negatively associated to successful implementation.	YES
-Following a wrong strategy will be negatively associated to successful implementation.	YES
-Not considering other alternatives to merger or acquisitions will be negatively associated to successful implementation.	NO DATA FOUND[148]
-Overestimation of potential synergies is related to less successful implemented M&A.	YES
-Higher premiums are related to less successfully implemented M&A	NO DATA FOUND
-Wrong management of the integration is related to less successfully implemented M&A.	YES
-Ignoring customers during the integration will lead to less successfully implemented M&A	YES
-Not examining the financial position of the acquired company will lead to less successfully implemented M&A.	NO DATA FOUND
-Incomplete or inadequate due diligence will lead to less successfully implemented M&A.	YES
-Implementations made quickly will be associated to successful implementation.	YES
-Clarity of acquisition purpose will be associated to successful implementation.	YES
-High degree of target management co-operation will lead to successfully implemented M&A	YES

For all those proposition we have found information, the findings of the case study correspond with the existing theory.

[148] Please, note that when we write “no data found” it can mean that this point was not important for the success or failure of the acquisition. It can also mean that effectively we did not find any information about this point.

4.2 Quaker Snapple

4.2.1 Transaction background

Introduction to Quaker Oats

The Quaker Oats is one of America's biggest food companies. Since the foundation in 1891, the company focused on diversification. Their first market was the domestic ready-to-eat cereal market, but it expanded to food, grocery and toy businesses. In the 1960s the company expanded to Europe.[149]

In 1979, after William D. Smithburg was signed as the new CEO, Quaker Oats diversified to the clothing and optical industries, and he launched an aggressive program in order to streamline the production through chain management. He also renewed the company's focus on customer satisfaction.[150]

In 1983, Quaker acquired Stokely-Van Camp, which included the acquisition of the beverage Gatorade, which nowadays is leader of its segment with an 80 per cent of market share.[151] According to William D. Smithburg, "*had we not bought Gatorade in the 1980s*", which has consistently brought double-digit growth. "*Quaker would not have existed beyond that time*".[152]

Introduction to Snapple Beverage Corporation

Snapple, originally Unadulterated Food Products, Inc. was created in 1972 by three childhood friends, Leonard Marsh, Hyman Golden and Arnold Greenberg. They started selling pure fruit drinks to health food stores in Greenwich Village, New York.[153]

In 1987, they started making iced tea, with a high quality, "new age", and ready-to-drink tea. This was an important step for the future success of the company.[154]

In 1992, the Thomas H. Lee Company of Boston proposed a buy-out, renamed the company Snapple and made it public one year later. In order to become Snapple a National company they started an advertising campaign focused on "customer relations, regular people" theme. The intention was to position the company as a "quirky" brand. Apart from this advertising campaign, Snapple started an employee loyalty and aggressive distribution strategy. Snapple had a huge and dependable network of distributors. These distributors could sell other brand's products, which allowed them to get high margins and profitability. Snapple also had a people-focused management style.[155]

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[149] Tuck School of Business at Dartmouth, "*Quaker Oats and Snapple* "nº 1-0041, p.1
[150] Ibid
[151] Ibid
[152] Interview with William D. Smithburg, former CEO of Quaker Oats, January 18, 2001
[153] www.snapple.com, May 2, 2007
[154] Tuck School of Business at Dartmouth, "*Quaker Oats and Snapple* "nº 1-0041, p.2
[155] Ibid

Introduction to Quaker Snapple

The initial purpose of the acquisition of Snapple was to exploit the synergies between the new age beverages of Snapple and the sporting drink Gatorade. The Quaker Beverage Division was formed, with the Gatorade and Snapple franchises representing one-third of the sales.[156] The rest of the story will be presented later on.

4.2.2 Transaction

Expected results

Quaker Oat thought that combining the Gatorade brand with Snapple would allow them to achieve important synergies. Snapple was not able to compete directly with the beverage giants Coca-cola and PepsiCo, but Quaker Oat considered that its financial strength and leadership experience could allow them to expand the Snapple brand nationally and internationally. The immediate benefit for Quaker Oat was becoming the third biggest beverage company in the US.[157]

Real results. Was the acquisition a success?

Just after the purchase, Snapple's shares declined during a long period. Three years after the acquisition of Snapple for $1.7 billion, Quaker Oats sold the company to Triarc for $300 million, which represents a loss of more than $1 million a day.[158] In addition to this loss of $1.4 billion, Quaker absorbed more than $100 million in cash losses and Quaker's credit rating suffered.[159]

Quaker Oat had operating losses of $85 million in 1996, and a loss of $1.4 billion in the first quarter of 1997.[160]In the year after the acquisition, Quaker's share prices went down from $37.5 to $33.[161]

In order to finance the acquisition, Quaker divested a number of businesses that historically were profitable and internationalized. The pet food and candy businesses are examples of these divestitures.[162]

Why did the acquisition fail?

Proposition 1: Less cultural differences will be positively associated to successful implementation.

Proposition 2: No post acquisition planning will be negatively associated to successful implementation.

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[156] Tuck School of Business at Dartmouth, "*Quaker Oats and Snapple* "nº 1-0041, p.3
[157] Ibid, p.3
[158] Quaker Oats to Sell Its Snapple Business," The Wall Street Journal, March 28, 1997
[159] Kenneth R. Ferris, Barbara S. Pécherot Petitt, *"Valuation, Avoiding the Winners Curse"*, p.15
[160] Paul C. Nutt, *"Expanding the Search for Alternatives During Strategic decision-making"*, p.5
[161] Baumohl, Bernard, Greenwald, John, *"Drinking problem"*, Time, 4/22/96, Vol. 147, Issue 17
[162] Tuck School of Business at Dartmouth, "*Quaker Oats and Snapple* "nº 1-0041, p.3

Proposition 3: Lack of knowledge of industry or target firm will be negatively associated to successful implementation.

As we have explained before, even though both companies were operating inside the beverage sector, they were focused on different customers. Quaker Oats was especially orientated in the energy drinks market, with its drink Gatorade being the leader of the market, whereas Snapple was orientated to healthy drinks, especially tea drinks.

By July 2004, Snapple was the fastest growing beverage company. However, Quaker Oats failed in anticipating the changes that the tea market was experiencing. By the end of the year, the tea market growth rate slowed down. The competition in the market increased since Pepsi invested a huge capital amount in national marketing campaigns. New entrants, like Mystic, Nantucket Nectars, or Arizona Iced teas lowered the market share of Snapple through product innovation and niche strategies.[163]

Apart from the lack of knowledge about the niche Snapple was attending, Quaker Oat suffered from no previous knowledge of the company. For instance, Quaker Oats was unexpectedly forced to invest $30 million to improve Snapple's loose manufacturing process.[164]

Proposition 4: No prior acquisition experience will be negatively associated to successful implementation.

William Smithburg, former CEO of Quaker Oat, did some successful acquisitions, specially the acquisition of Gatorade. "*Smithburg acquired Gatorade impulsively, basing the acquisition in his taste buds*". Analysts were really critical of the Gatorade acquisition, but Smithburg proved that they were wrong since the company that was worth $220 million became into a company worth $3 billion. Due to this success, board of the directors of Quaker Oats gave total freedom to Smithburg for the future acquisitions, and Smithburg ensured that applying the same tactics of previous successful acquisitions would be enough for a new success[165]

Smithburg thought that by following the same principles of the acquisition of Gatorade he would be able to achieve the same success, but the result was the opposite. As he pointed out just after the acquisition, "*We have an excellent sales and marketing team here at Gatorade. We believe we do know how to advance Snapple as well as Gatorade to the next level*".[166]

In this case we can say that the previous success on the acquisition of Gatorade was one of the reasons for the failure of the acquisition of Snapple, since the managers were too confident about the success of the acquisition just following the same steps of the acquisition of Gatorade.[167]

Proposition 5: Following a wrong strategy will be negatively associated to successful implementation.

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[163] Tuck School of Business at Dartmouth, "*Quaker Oats and Snapple* "nº 1-0041, p.3
[164] Ibid, p.4
[165] Paul C. Nutt, "*Expanding the Search for Alternatives During Strategic decision-making*", p.5
[166] Sydney Finkelstein, " *The Seven Habits of Spectacularly Unsuccesful Executives*", p.6
[167] Sayan Chatterjee, "*Why is Synergy so Difficult in Mergers of Related Businesses*"

Proposition 6: Not considering other alternatives to merger or acquisitions will be negatively associated to successful implementation.

Smithburg was obsessed with the idea of suffering a takeover, and he thought that an acquisition of a company with high debt should be made as soon as possible. Not time and money was used to valuate other ideas. Searching for an alternative acquisition with a better strategic fit would have revealed pitfalls that in that moment Smithburg did not want to reveal. Better ideas for revitalizing the company might have emerged also.[168]

Proposition 7: Overestimation of potential synergies is related to less successful implemented M&A.

The success of the integration of both companies was related to the realization of the synergies by integrating the distribution channels of Gatorade and Snapple. This issue turned to be impossible. Smithburg explained the situation as following:

"We went to the distributors and said, 'we at Quaker are very good at warm channels… we will give you all of Gatorade's cold channels'. The distributors responded, 'it's brilliant, it make sense, no way! The distribution synergies turned out to be a flawed strategy… it was not synergistic as we thought. We could see it six months into the acquisition"[169]

Proposition 8: Higher premiums are related to less successfully implemented M&A

Quaker Oat paid $1.7 billion for the acquisition of Snapple. According to most of the industry analysts, the company was worth $1 billion maximum.[170] This represented a premium of 28.6 times earnings and 330 per cent of revenues.[171]

Proposition 9: Wrong management of the integration is related to less successfully implemented M&A.

As we said before, the board of the directors was not able to monitor the way Smithburg was running the company. They thought that applying the same strategy as the acquisition of Gatorade would be enough.

Proposition 10: Ignoring customers during the integration will lead to less successfully implemented M&A

In the case of this acquisition, Snapple's customers were used to a personal relationship with the brand. When Quaker acquired the company, the size of the new company made this personal relationship impossible. "*Snapple's customers were able to see the difference between a real and a pseudo-relationship"*.[172]

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[168] Paul C. Nutt, *"Expanding the Search for Alternatives During Strategic decision-making"*, p.6
[169] Constante Helfat, *"Dynamic Capabilities, Understanding Strategic Change in Organizations"*, p.59
[170] http://www.morevalue.com/glossary/restrict/Divestiture-Snapple.html, may 4, 2007
[171] Tuck School of Business at Dartmouth, "*Quaker Oats and Snapple* "nº 1-0041, p.3
[172] McMath and Robert M. ""*The David and Goliath Syndrome*", (07/1997), American Demographics, vol. 19 issue 7.

The market share of Snapple in the ice-tea market got down from a 30 per cent of the US market to a 24 per cent the year after the acquisition.[173]

Proposition 11: Not examining the financial position of the acquired company will lead to less successfully implemented M&A.

Proposition 12: Incomplete or inadequate due diligence will lead to less successfully implemented M&A.

The acquisition of Snapple was an example of a failed due diligence. Quaker failed in understanding Snapple's business. As Smithburg said, *"I am not critical of the distributors. Our error was not understanding them on their business and culture as well as we should have"*.

Quaker knew how to advertise and distribute a product like Gatorade, but the lack of due diligence and integration planning contributed to the failure of the acquisition. Some years after the acquisition of Snapple, Smithburg recognized the lack of due diligence. *"There was so much excitement about bringing in a new brand, a brand with legs. We should have had a couple of people arguing the 'no side' of the evaluation"*.[174]

Proposition 13: Implementations made quickly will be associated to successful implementation.

Proposition 14: Clarity of acquisition purpose will be associated to successful implementation.

Proposition 15: High degree of target management co-operation will lead to successfully implemented M&A.

In the case of the acquisition of Snapple by Quaker Oats, the main managers of Snapple abandoned the company just after the acquisition of the company. Two of the three founders, Golden and Greenberg, left the company. Half of Snapple's field sales division and many executives were forced out.[175]

Quaker Oat's managers did not try to get the collaboration from the Snapple's executives. As William Smithburg recognizes, *"We frankly knew this - that there was management there"*.[176] *"None of Snapple stayed on…Marsh did a little bit, but pretty minor"*.

Marsh, the only cofounder that stayed in the company said, *"I was the Executive Vice President in charge of nothing"*. [177]

[173] Michael White, *"Short Curse in International Marketing Blunders"*, (2002), p.120
[174] Constante Helfat, *"Dynamic Capabilities, Understanding Strategic Change in Organizations"*, p.59
[175] Tuck School of Business at Dartmouth, "*Quaker Oats and Snapple* "nº 1-0041, p.3
[176] Ibid, p.3
[177] Constante Helfat, *"Dynamic Capabilities, Understanding Strategic Change in Organizations"*, p.60

New facts found that explain the merger failure

- Personal interests of the CEO William Smithburg: Before the acquisition of Snapple, Quaker had become a takeover target. Smithburg thought that acquiring a company with a huge debt would discourage a takeover. Why avoiding a takeover? Even though a takeover is good news for the stakeholders of the target company, with an average premium paid of a 36 per cent, Smithburg's image of a "golden boy" would have been seriously affected. He would have been condemned for having a less important role in the new organization or perhaps not role at all. The acquisitions of Snapple contributed to this purpose, since Quaker' stocks fell down a 10 per cent.[178]

- Problems with the distribution channels: Quaker used to sell its sport drinks trough convenience stores and supermarkets while Snapple used to sell its healthy drinks trough delis and corner stores. Quaker believed that expanding the distribution channels of Snapple into bigger shops and Gatorade into convenience shops would increase de sales.[179]

Snapple's distributors, who had built the brand, resisted to the idea since they did not want to reduce their profitability. As one of Snapple's oldest and largest distributors said, *"Snapple (Quake) had a dual distribution proposal. Wasn't really in the best interests for me at the time. Ninety percent of my sales are Snapple and that would have really hurt...my business. Gatorade doesn't carry the same margin as Snapple, and I don't believe for a minute that the ball game is over. So far, Quaker speaks with forked tongue quite frequently."*[180]

Snapple's loyal customers felt alienated since they were used to a personal relationship with the brand, and they did not want to feel as another customer of the fashion brand Gatorade. The sales decreased considerably.[181]

- Marketing mistakes:

Gatorade was a "fluid replacement product" while Snapple was an "image" drink. Snapple's success was based on a "quirky" marketing that allowed them to create a cult drink. Gatorade was promoted in a more traditional way and was aggressively segmented.[182]

According to the New York Times[183], *"Quaker discontinued its quirky campaign, featuring a Snapple employee named Wendy Kaufman, and replaced it with one in which Snapple boasted that it would be happy to be third behind Coca-Cola and Pepsi in the beverage market."*

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[178] Paul C. Nutt, *"Expanding the Search for Alternatives During Strategic decision-making"*, p.5
[179] Orit Gadiesh, Charles Ormiston, Sam Rovit, *"Achieving an M&As Strategic Goals at Maximum Speed for Maximum Value"*
[180] Bill Trebilcock, President of Mid-Continent Bottlers in West Des Moines, Iowa, quoted in Miller, Hilary S., "Quaker shelves joint distribution system." Beverage Industry. February 1, 1995, p. 17
[181] Gopinath C. "*When Acquisitions go Awry: Pitfalls in Executing Corporate Strategy"*, Vol 24. nº5, p.22
[182] Constante Helfat, *"Dynamic Capabilities, Understanding Strategic Change in Organizations"*, p.59
[183] The New York Times, March 28, 1997

Does the case correspond with the reality?

Table 4.4 Proposition compared to the theory. Quaker Snapple

Existing Theory	It corresponds with the theory
-Less cultural differences will be positively associated to successful implementation.	NO DATA FOUND
-No post acquisition planning will be negatively associated to successful implementation.	NO DATA FOUND
-Lack of knowledge of industry or target firm will be negatively associated to successful implementation.	YES
-No prior acquisition experience will be negatively associated to successful implementation.	NO
-Following a wrong strategy will be negatively associated to successful implementation.	NO DATA FOUND
-Not considering other alternatives to merger or acquisitions will be negatively associated to successful implementation.	YES
-Overestimation of potential synergies is related to less successful implemented M&A.	YES
-Higher premiums are related to less successfully implemented M&A	YES
-Wrong management of the integration is related to less successfully implemented M&A.	YES
-Ignoring customers during the integration will lead to less successfully implemented M&A	YES
-Not examining the financial position of the acquired company will lead to less successfully implemented M&A.	NO DATA FOUND
-Incomplete or inadequate due diligence will lead to less successfully implemented M&A.	YES
-Implementations made quickly will be associated to successful implementation.	NO DATA FOUND
-Clarity of acquisition purpose will be associated to successful implementation.	NO DATA FOUND
-High degree of target management co-operation will lead to successfully implemented M&A	YES

Although most of the findings from this case correspond with the theory, there is one particular case where this is not like this. The prior acquisition experience of Quaker was one of the reasons that contributed to the failure of the acquisition.

4.3 BP and AMOCO

4.3.1 Introduction to the petroleum industry[184]

The petroleum industry includes several operating segments. The exploration and production segments involve the exploration of crude and natural gas, and the marketing of natural gas. The refinery and the marketing segment include the petroleum refining operations, marketing of petroleum products, and the transportation of those products. Finally, the chemical sector is the responsible for manufacturing and marketing petroleum based on chemical products. The biggest international oil companies are involved in the three segments.

In the year 1998, when BP acquired Amoco, the supply of oil was much bigger than the demand in order to attend the greater demand that was expected in the following years. The oil and gas natural prices started dropping since the beginning of 1997 until the year 1998. These lower prices reduced the incentives of the oil companies for searching for petroleum and keeping the production levels.

4.3.2 Acquisition background

Introduction to BP[185]

BP, one of the largest petroleum and petrochemical companies in the world, was created in 1909. Nowadays, the BP group is established in Europe, the U.S., Australasia, and parts of Africa, and is expanding in areas like China, South East Asia, South America and the former Soviet Union.

BP's main businesses are production and exploration, refining and marketing and chemicals. Before 1992, BP had some important weaknesses. BP became extremely dependent on two oil fields: its reserve replacement ratio (percentage of oil and gas production that is replaced every year by new reserves), was the 69 per cent, and they had higher costs than the competence.[186]

Due to these weaknesses, BP changed the CEO and introduced a successful strategy of cost cutting and core investments. Between 1993 and 1997, BP invested almost $16 billion in capital expenditure and acquisitions, which reduced its net debt from $15.1 billion to $6.9 billion.

During this period, the exploration and production business focused on maximising the value realisable from existing assets and growing in those areas where low cost and high valuable reserves could be found. Due to this strategy, BP was able to achieve a record of more than one productive exploration out of two.

The strategy in the refining and marketing business was to reduce costs and improve BP's assets portfolio. Some refineries of the USA were sold, and the rest of them were the object of an investment program that allowed them to be competitive in their own

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[184] http://papers.ssrn.com/sol3/papers.cfm?abstract_id=908072, may 11, 2007
[185]http://www.bp.com/liveassets/bp_internet/globalbp/STAGING/global_assets/downloads/A/Amoco_F4_Filing.pdf, May 11 2007
[186] http://papers.ssrn.com/sol3/papers.cfm?abstract_id=908072, may 11, 2007

markets. The portfolio of marketing assets was reshaped continually through a process of strategic divestments.

Chemicals focused on investing in places which offered competitive advantages and divesting in those assets that were not in the core business

Introduction to Amoco[187]

Before the merger, Amoco had a history of 109 years. It had operations in more than 30 countries, employed 43,400 people worldwide, owned more than $32 billion in assets, and generated more than $2.7 billion net income in the year 1997. Amoco was divided in three businesses: the exploration and production business, the petroleum product business and the chemicals business.

During the 1990s, Amoco focused on partnering and international growth. For example, Amoco entered into a joint venture with Shell Oil Company and Sonat Exploration to deliver gas natural from the Gulf of Mexico.

As we can see in the next table, before the transaction, Amoco's financial performance was worse than most of the other players in the industry. The ROCE was lowering in the last years.[188]

Table 4.5 Roce 1992-1997. Amoco

	1992	1993	1994	1995	1996	1997
RD/Shell	7.0	6.8	5.7	7.7	11.1	10.0
Amoco	7.4	8.1	8.5	10.2	11.1	11.0
Texaco	7.9	9.4	9.2	11.3	13.8	11.8
Exxon	9.3	9.7	9.5	12.7	13.4	15.8
Chevron	7.1	10.0	7.5	8.6	12.8	14.1
Movil	5.9	8.8	8.9	11.5	12.0	12.9
BP	2.9	5.9	8.3	11.6	14.5	15.4

Introduction to BP Amoco

The combination of both companies ended the last day of December, 100 days after the announcement of the approval. BP Amoco became the third largest oil company in the world, the largest corporation in the UK and the largest industrial merger ever.[189]

The market capitalization in the year 2006 is $220 billion, sales of $266 billion, owns 24,600 service stations and 16 refineries and employs 97,000 people all over the world.[190]

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[187] http://www.bp.com/liveassets/bp_internet/globalbp/STAGING/global_assets/downloads/A/Amoco_F4_Filing.pdf, May 11 2007

[188] http://papers.ssrn.com/sol3/papers.cfm?abstract_id=908072, 11 may 2007

[189] David Rubenstein, *"AT BP AMOCO, an Efficient Acquisition and a Swift Ax"*, p.2

[190] http://www.bp.com/extendedsectiongenericarticle.do?categoryId=9010452&contentId=7019611, 11 may 2007

4.3.3 Transaction

Although the company announced that the transaction was an alliance of equals, the merger was an acquisition. The CEO of BP Amoco was Sir John Browne, former CEO of BP, and the new company was based on the BP's London headquarters.[191] BP owned the 60 per cent of the shares while Amoco counted for a 40 per cent. [192]

Each Amoco´s share was converted into and cancelled in exchange for 3.97 BP Amoco´s ordinary shares, which were delivered in the form of Amoco ADSs.[193]

Expected results

The company expected at least $2 billion in synergies by the end of 2000. These synergies would be the consequence of a costs reduction. This costs reduction would come from the staff reduction, more focused exploration efforts, standardisation and simplification of business processes, improve procurement and the elimination of duplicative operations.[194]

The price-earning ratio of the biggest companies of the sector, Shell and Exxon, was bigger than those of the small companies. One of the consequences expected by the members of the directors of BP and Amoco was to reach the price-earning ratio level of the biggest companies.[195]

Real results

As Nick Starrit, British Petroleum Human Resources Group Director, states, *"It was a successful acquisition…because it achieved more synergies than had originally been forecasted…It achieved them faster than we had forecasted…it went further and faster than we had promised the market and the shareholders…"*

"BP Amoco is one of the most successful of integration strategies" (Angus-Knowles-Cutler, Mergers and Acquisitions Vice-president for Cap Gemini–Ernst Young)[196]

Why did the acquisition success?

Proposition 1: Less cultural differences will be positively associated to successful implementation.

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[191] David Rubenstein, *"AT BP AMOCO, an Efficient Acquisition and a Swift Ax"*, p.1
[192] Alzira Salama, Wayne Holland and Gerald Vinten, *" Challenges and Opportunities in Mergers and Acquisitions: Three International Case Studies"*, Journal of European Industrial Training Volume 27 Number 6 2003 pp. 313-321
[193]http://www.bp.com/liveassets/bp_internet/globalbp/STAGING/global_assets/downloads/A/Amoco_F4_Filing.pdf, May 9, 2007
[194]http://www.bp.com/liveassets/bp_internet/globalbp/STAGING/global_assets/downloads/A/Amoco_Circular.pdf, may 9, 2007
[195]http://www.bp.com/liveassets/bp_internet/globalbp/STAGING/global_assets/downloads/A/Amoco_F4_Filing.pdf
[196]Alzira Salama, Wayne Holland and Gerald Vinten, *" Challenges and Opportunities in Mergers and Acquisitions: Three International Case Studies"*, Journal of European Industrial Training Volume 27 Number 6 2003 pp. 313-321

In order to integrate the different cultures of both companies, several meetings were held between the top 500 managers of the resulting company. In those meetings, BP's operating philosophy was explained. During those events, managers from both companies were encouraged to socialize and mix with their counterparts from the other company.[197]

As Paul Weissgarber, Vice President of the Oil and Gas division for A.T. Kearney, said before the transaction, *"The BP and Amoco cultures seem to be compatible. They seem to have similar cultural roots and good work ethics. Amoco has the 'work hard, play hard' Midwestern roots and BP has a similar background. They aren't about flash, but about results. They have similar approaches on how to do business.*"[198]

Proposition 2: No post acquisition planning will be negatively associated to successful implementation.

Before the acquisition took place, an integration team was created in order to success in the integration of both companies. The leader of the integration team was a Senior Line Manager, who was reporting directly to the CEO. In this integration team, leaders from different divisions and departments of both companies were represented. The integration team focused on combining two head offices and two operating divisions.[199]

Proposition 3: Lack of knowledge of industry or target firm will be negatively associated to successful implementation.

One of the reasons for combining both companies was the strategic and geographic fit of them. BP's and Amoco's businesses were complementary, and also the countries they were working in.

In addition to this, BP and Amoco considered that they were already sharing some fundamental management philosophies. For instance, the new company wanted to continue pursuing sustainable growth with a target ceiling on net debt to net debt plus equity of around 30 per cent, and continue with the dividend policy of a 50 per cent pay-out ratio. [200]

Proposition 4: No prior acquisition experience will be negatively associated to successful implementation.

BP used the knowledge that it acquired from joint ventures and mergers that were carried out before. They interviewed the key people in those joint ventures and mergers in order to learn from those experiences. This knowledge was made public on the intranet of BP Group, becoming the M&A team the responsible for the information

[197] Alzira Salama, Wayne Holland and Gerald Vinten, *" Challenges and Opportunities in Mergers and Acquisitions: Three International Case Studies"*, Journal of European Industrial Training Volume 27 Number 6 2003 pp. 313-321

[198] *"Industry anticipates effects of merger"*., National Petroleum News, 01495267, Oct98, Vol. 90, Issue 10

[199] Alzira Salama, Wayne Holland and Gerald Vinten, *" Challenges and Opportunities in Mergers and Acquisitions: Three International Case Studies"*, Journal of European Industrial Training Volume 27 Number 6 2003 pp. 313-321

[200]http://www.bp.com/liveassets/bp_internet/globalbp/STAGING/global_assets/downloads/A/Amoco_F4_Filing.pdf, May 9, 2007

base. This intranet was also used in order to connect the top executives, the integration team and the staff all over the world.[201]

Proposition 5: Following a wrong strategy will be negatively associated to successful implementation.

The strategy of both companies was to become one of top three companies in oil and gas reserves, have a global presence in refining and marketing and have a significant position in petrochemicals. The acquisition of Amoco was the perfect step for achieving this purpose since the company was stronger in natural gas. It was stronger in the American refining and its marketing market. Consequently, this acquisition achieved a portfolio of chemical products that complemented those of BP.[202]

Proposition 6: Not considering other alternatives to merger or acquisitions will be negatively associated to successful implementation.

The managers of Amoco and BP looked for different ways of improving their competitive positions, including possible business combinations, joint ventures and other kind of transactions. Among these possible transactions, Amoco and BP considered the possibility of creating a joint venture involving only the petrochemicals businesses of the two companies. This possibility was rejected since the companies were not able to identify any synergy.[203]

The next possible combination that was considered was to create a dual holding company structure. With this structure, Amoco and BP would continue their existences as separated public companies, with their own publicly traded stock markets, but managing the businesses of the two companies by the same boards of directors and senior executives. This possibility was rejected due to the complex structure of the new company. Finally, both companies agreed in the creation of a stock-for-stock merger.[204]

Proposition 7: Overestimation of potential synergies is related to less successful implemented M&A.

As we have pointed out above, the expected synergies, due to the transaction, were $2 billion. These synergies were expected to be achieved in three years. The real result was achieved in only one year.[205]

Proposition 8: Higher premiums are related to less successfully implemented M&A

Morgan Stanley, financial adviser of Amoco, reviewed eleven comparable transactions and compared the implied premium to the relative market capitalization of the smaller company. The result of this study verified that the premiums were in a range between 5

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[201] Maria Rumyantseva, Grzegorz Gurgul and Ellen Enkel, *Knowledge Integration after Mergers & Acquisitions",* p. 25
[202] http://papers.ssrn.com/sol3/papers.cfm?abstract_id=908072, 11 may, 2007
[203] http://www.bp.com/liveassets/bp_internet/globalbp/STAGING/global_assets/downloads/A/Amoco_F4_Filing.pdf, May 9, 2007
[204] http://www.bp.com/liveassets/bp_internet/globalbp/STAGING/global_assets/downloads/A/Amoco_F4_Filing.pdf, May 9, 2007
[205] Orit Gadiesh, Charles Ormiston, Sam Rovit, *"Achieving an M&As Strategic Goals at Maximum Speed for Maximum Value"*

and 15 per cent. The premium paid to the shareholders of Amoco was 13.3 per cent, which was within this range. [206]

Proposition 9: Wrong management of the integration is related to less successfully implemented M&A.

Proposition 10: Ignoring customers during the integration will lead to less successfully implemented M&A

Proposition 11: Not examining the financial position of the acquired company will lead to less successfully implemented M&A.

Proposition 12: Incomplete or inadequate due diligence will lead to less successfully implemented M&A.

The integration team, created in order to achieve a proper integration of both companies, was also responsible for investigating the possible synergies related to the integration and the ways for achieving them.[207]

Proposition 13: Implementations made quickly will be associated to successful implementation.

The Chief Executive John Browne, working together with the integration team, filled in all the senior management jobs and completed almost all the job cuts in the first 100 days after the transaction, which was a record for two companies of such a big size.[208]

Proposition 14: Clarity of acquisition purpose will be associated to successful implementation.

The reasons for the acquisition of Amoco were clear before the transaction was made. The main reason was to create a more competitive, global energy, and petrochemical company that would lead to a greater value for the shareholders. The factors contributing for this creation of value were:[209]

- Scale, financial strength and distinctive assets: The merger would create one of the biggest oil companies in the world with earnings bigger than $6 billion, and a market capitalization of $110 billion. The new company would be able to have access to new investment opportunities, bigger market presence and new technological skills. The new company would have access to new investment possibilities, which were only available to the most competitive companies.

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[206] http://www.bp.com/liveassets/bp_internet/globalbp/STAGING/global_assets/downloads/A/Amoco_F4_Filing.pdf, May 9, 2007

[207] Alzira Salama, Wayne Holland and Gerald Vinten, *" Challenges and Opportunities in Mergers and Acquisitions: Three International Case Studies"*, Journal of European Industrial Training Volume 27 Number 6 2003 pp. 313-321

[208] Orit Gadiesh, Charles Ormiston, Sam Rovit, *"Achieving an M&As Strategic Goals at Maximum Speed for Maximum Value"*

[209] http://www.bp.com/liveassets/bp_internet/globalbp/STAGING/global_assets/downloads/A/Amoco_F4_Filing.pdf, May 9 2007

- Synergies. As we mentioned before, the synergies expected to be obtained were $2 billion.

Proposition 15: High degree of target management co-operation will lead to successfully implemented M&A.

The acquisition of Amoco by BP was supported by the management of both companies. Before the transaction was made, the CEOs from both companies worked together, as well as the other managers from the company. Even though there was a high degree of co-operation between both companies, there were also some problems.

Although it was clear since the beginning that BP's management would dominate the Amoco's management, they were reluctant to change the management style. Amoco's management found that the less bureaucratic way of management from BP was difficult to accept.[210]

New facts found

Monitoring the progress of the integration; the integration team was responsible for surveying every month a sample of staff working in the big locations during the first 18 months after the acquisition. These surveys provide the top managers with valuable information about the process of the integration and the commitment of the staff with the new company.[211]

Negative aspects

Due to this transaction, 14,500 jobs were cut, 8,500 more than the initial forecast. Some of the synergies that were expected from both companies were consequence of the lower costs, and labour cost was the most important between them.[212]

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[210] http://papers.ssrn.com/sol3/papers.cfm?abstract_id=908072, may 11, 2007

[211] Alzira Salama, Wayne Holland and Gerald Vinten, *" Challenges and Opportunities in Mergers and Acquisitions: Three International Case Studies"*, Journal of European Industrial Training Volume 27 Number 6 2003 pp. 313-321

[212] http://news.bbc.co.uk/1/hi/business/the_company_file/149139.stm, may 11, 2007

Does the case correspond with the theory?

Table 4.6 Proposition compared to the theory. BP Amoco

Existing Theory	It corresponds with the theory
Less cultural differences will be positively associated to successful implementation.	NO DATA FOUND
No post acquisition planning will be negatively associated to successful implementation.	YES
Lack of knowledge of industry or target firm will be negatively associated to successful implementation.	YES
No prior acquisition experience will be negatively associated to successful implementation.	YES
Following a wrong strategy will be negatively associated to successful implementation.	YES
Not considering other alternatives to merger or acquisitions will be negatively associated to successful implementation.	YES
Overestimation of potential synergies is related to less successful implemented M&A.	YES
Higher premiums are related to less successfully implemented M&A	YES
Wrong management of the integration is related to less successfully implemented M&A.	NO DATA FOUND
Ignoring customers during the integration will lead to less successfully implemented M&A	NO DATA FOUND
Not examining the financial position of the acquired company will lead to less successfully implemented M&A.	YES
Incomplete or inadequate due diligence will lead to less successfully implemented M&A.	YES
Implementations made quickly will be associated to successful implementation.	YES
Clarity of acquisition purpose will be associated to successful implementation.	YES
High degree of target management co-operation will lead to successfully implemented M&A	YES

The findings of the case correspond with the existing theory.

4.4 Telia Sonera

4.4.1 Introduction to TeliaSonera in the telecommunication industry

"*We in this industry have made it so complex over the years. It is about time that we put the costumers in the centre and thought about what they want. We want things to work, they want them to be easy to use, easy to buy and easy to understand" [213]*

Igel, Anders. President and CEO of TeliaSonera

TeliaSonera is nowadays one of the leading telecommunication providers in Europe. The main advantages of this position are economies of scale and brand image. But the main disadvantage when combining with other companies is to become "a national champion in a faceless multinational".[214] These kinds of companies are expected to grow internationally by increasing sales in order to face the huge expenses in research and development. TeliaSonera´s markets have been related to price pressure with the exception of Finland. The lower prices were offset by increasing sales volumes. TeliaSonera´s sales increased 8 per cent during 2006, excluding fixed voice sector which declined 5 per cent[215]

In respect of the sector of broadband the demand continued to be strong during the last year. The market still offers many opportunities of enhancing businesses. The main factors for this development are the music and videos downloads and shopping by internet. According to the analyst firm Forrester Research, "*the current number of internet users who shop on internet is more than 50 percent and this number is increasing in Western Europe*". Moreover, the most common purchases are vacation trips, books, tickets CDs and clothes. TeliaSonera is expected to continue increasing the number of broadband services and the demand is thought to be stronger in broadband connections to homes.[216]

The telecommunication industry must face the consolidation of the sector. Recently other companies have acquired more firms. The main examples are the acquisition of NOOS by UPC and the merger between Neuf Telecom and Cegetel. The result of these movements in the market is that the number of telecom companies has decreased and thus the competitor becomes stronger and lower margins might affect the profitability of TeliaSonera. These margins will be positively related to continued efficiency improvements and increased volumes and negatively by lower prices.[217]

But this issue is still a very new one and the combination above mentioned are not between "main players" or incumbents. Thereby, we have found more failure attempts like Telia with the Norwegian Telenor in 1999, and more recently Telecom Italia with Deutsche Telekom, Telefonica from Spain and KPN from Holland and the most ambitious of them France Telecom with Deutsche Telekom, whose Joint Venture Global One was suppose to end in a merger, but no one of these combination was

[213] Ingel Anders.President and CEO TeliaSonera.Telecommunication internacional edition. 1/2005, p. 19
[214] Ian Scales, *"Why Sonera/Telia could be an anomaly"*..America's Network 15/5/2002, p.23
[215] http://www.teliasonera.se/ April 25, 2007
[216] http://www.teliasonera.se/ April 25, 2007
[217] http://www.teliasonera.se/ April 25, 2007

carried out. Thus, after a decade of merger plans and some occasional attempts, two European incumbents may achieve this. [218]

This industry is very dynamic in the sense that companies need to maintain their competitiveness. New technologies and business opportunity arise pretty often. The different firms design new product and services constantly in order to feed the demand. Most of the firms are working with some kind of alliance. The majority of them are networked vertically with some value-chain partners, but lately, it is increasing the number of alliances laterally which look for companies across industries[219].

Another common issue is that most of the companies in this industry are in continuous cutting-cost, searching for efficiency and providing value to their shareholders. New challenges like the ICT market are making the firms to behave more as a corporation, considering common R&D expenses for instance.[220]

TeliaSonera wants to be perceived as a company which makes products and services that are easy to use by customers. Furthermore the group has been elected during 2006 to the Down Jones Global Sustainability Index (DJSI), confirming that TeliaSonera is working well in terms of sustainability, since only 10 per cent of the world's most outstanding companies in each industry are included here.[221]

Recently, in January 2007, when the last storm occurred, TeliaSonera offered a large number of alternatives to its costumers to reduce the inconveniences without any charge. The group is also contributing to the reduction of the greenhouse effect and the CO2 emissions.[222]

Moreover, the telecommunication industry in Europe is regulated by the EU Commission, which has finished a public consultation on ideas to modernize the industry. In summer 2007 the commission will be proposing new directives in order to increase incentives for investments and growth. It might be harmful for some companies because they are expected to be implemented in the subsequent years by the member states.[223]

4.4.2 Merger background

Introduction to Telia[224]

Televerket was the only provider of public voices telecommunication services for a long time until the 1980s, when, due to the increase in the IT, new firms entered into the market.

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[218] Ian Scales, *"Why Sonera/Telia could be an anomaly"*. America's Network 15/5/2002. p. 23

[219] Blomquist kirsimarja, Hara Veikko, Koivuniemi Souni, Äijö Toivo , *"Towards networked R&D management: the R&D approach of Sonera Corporation as an example."* R&D management, 11/2004, p. 591

[220] Ibid

[221] http://www.teliasonera.se/ April 25, 2007

[222] http://www.teliasonera.se/ April 25, 2007

[223] http://www.teliasonera.se/ April 25, 2007

[224] http://www.teliasonera.se/ April 25, 2007

Many changes were established in 1993. The government introduced a new law requiring all companies to apply for a license if they wanted to provide large scale telecommunication services. Also in 1993, Televerket was transformed from a state-owned public company into a limited one with the new denomination of Telia AB.

Then, in June 2000 Telia became a private company after the Swedish State sold almost a 30 percent of the shares in an Initial Public Offering. The Swedish government owned in 2002 most of the holding (71 per cent)[225]. Telia is listed on the A-list of the Stockholm Stock Exchange.

Introduction to Sonera[226]

Right after Finland became an independent state in 1917 Telegraph Office of Finland was created. Ten years later, a merger with the Post of Finland was carried out and renamed as Post and Telecommunication of Finland.

Post and Telecommunication of Finland had a monopoly in long distance and international telephone services until 1992 when the state of Finland developed new rules in order to motivate new operators to enter into this industry.

In 1994 the State businesses were split into Finland Post and Telecom Finland and three years later Telecom Finland was approved to be gradually a private company changing the name to Sonera.

Finally in 1998 the Finnish State decreased its holding until 77.8 percent in an Initial Public Offering and Sonera was listed on the Helsinki Stock Exchange. In the subsequent years the Finnish State continued reducing its holding till a 52.8 percent in 2000 remaining like that till 2002, before the merger.[227]

Introduction to TeliaSonera[228]

TeliaSonera is the result of the merger between Telia and Sonera, both of them leaders in their respective countries in the telecommunication industry. The merger took place in December 2002. TeliaSonera is a public limited company regulated under the Swedish law and listed on the Stockholmsbörsen, Helsinki Exchanges and Nasdaq.

Together, they are a leading Telecommunication group in the Nordic and Baltic countries and with broad market shares in other places like Russia and Turkey.

TeliaSonera. The group:

We do not want to speak too much of the group and its expanding strategy. Thus, we just provide some data in order to place TeliaSonera in different markets but our main study will be focused on the merger. We will also mention without many details the main acquisitions in different markets.

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[225] Ian Scales, *"Why Sonera/Telia could be an anomaly"*. America's Network 15/5/2002. p. 23
[226] http://www.teliasonera.se/ April 25, 2007
[227] Ian Scales, *"Why Sonera/Telia could be an anomaly"*. America's Network 15/5/2002, p. 23
[228] http://www.teliasonera.se/ April 25, 2007

The data in the tables[229] refers to the year 2005. These tables show several indicators that explain how TeliaSonera is expanding its position in many countries:

Table 4.7 TeliaSonera in Turkey

- In Turkey:

Net sales (USD in millions)	Group holding (%)	Trademarks	Services	Number of customers	Market Share (%)	Main Competitors
4,269	37.3	Turkcell	Mobile	26,700,000	64	Telsim, Avea

Turkcell is listed on the New York and Instambul Stock Exchanges.

Table 4.8 TeliaSonera in Russia

- In Russia:

Net sales (USD in millions)	Group holding (%)	Trademarks	Services	Number of customers	Market Share (%)	Main Competitors
2,388	43.8	MegaFon	Mobile	22,836,000	18	MTS, Vimpelcom

TeliaSonera owns 43.8 percent of MegaFon, which is the only operator with mobile license to sell all over the areas in the Russian market and the third one in market share.

Table 4.9 TeliaSonera in Euroasia

- In Euroasia:

	Net sales (SEK in millions)	Group holding (%)	Trademarks	Services	Number of customers	Market Share (%)	Main Competitors
Eurasia	6,367	74					
Kazakhstan			K'Cell	Mobile	3,320,000	67	K-Mobile
Azerbaijan			Azercell	Mobile	1,741,000	78	Bakcell
Georgia			Geocell	Mobile	715,000	49	Magticom
Moldova			Moldcell	Mobile	370,000	47	Voxtel

The most significant data here is that Telia Sonera owns the 74 percent of Fintur Holdings which offers mobile services in Kazakhstan, Azerbaijan, Georgia and Moldova via K'Cell, Azercell, Geocell and Moldcell respectivily reaching a developing area, in particular both Kazakhstan and Azerbaijan where the economies are growing fast, even the income per capita is still low in the whole area.

- In Spain:

TeliaSonera focuses nowadays in the Spanish market due to their, almost, 44 million inhabitants mainly. Spanish prices are expensive compared to the European average. There have been, for some years, three established players in the Spanish mobile market. Telefónica, Vodafone, and Amena. By acquiring the majority of Xfera in June 2006, TeliaSonera was able to launch into the market a new mobile operator called

[229] http://www.teliasonera.se/ April 25, 2007

Yoigo on December 1st. Knowledge, experience combine to a flexible and cost efficient organization are the key factors that TeliaSonera is using to succeed in the penetration in this hard market. Lower prices and a transparent policy of Simplicity for the costumers have been received very well by the Spanish consumers.

- In Lithuania:

Table 4.10 TeliaSonera in Lithuania

Net sales (SEK in millions)	Group holding (%)	Trademarks	Services	Number of customers	Market Share (%)	Main Competitors
2,302	100	Omnitel, Ezys	Mobile	1,889,000	49	Tele2, Bite
1,970	60	TEO	Fixed Voice	798,000	99	
		TEO	Datacom and Broadband	126,000	45	Skynet, Telerena, Balticum TV

This is the largest country with 3.4 million inhabitants in the Baltic countries. The economy is growing but the income per capita as in the other Baltic countries is still low. The GNP growth is even bigger than in the Nordic countries.

- In Latvia:

Table 4.11 TeliaSonera in latvia

Net sales (SEK in millions)	Group holding (%)	Trademarks	Services	Number of customers	Market Share (%)	Main Competitors
2,252	60.3	LMT	Mobile	735,000	45	Tele2, Zetcom
	49	Lattelecom	Fixed Voice	624,000	98	
		Lattelecom	Datacom and Broadband	68,000	30 *	Baltkom, Izzi

* Consumer broadband.

TeliaSonera owns the 60.3 percent of the mobile operator LMT and the 49 percent of the fixed network company Lattelecom.

- In Estonia:

Table 4.12 TeliaSonera in Estonia

Net sales (SEK in millions)	Group holding (%)	Trademarks	Services	Number of customers	Market Share (%)	Main Competitors
3,356	50.3 *	EMT, Diil	Mobile	677,000	47	Tele2, Elisa
		Elion	Fixed Voice	388,000	85	Tele2, Starman
		Elion	Datacom and Broadband	121,000	53 **	Starman, STV, Tele2

* 53.7 percent as of March 2, 2006.
** Consumer broadband.

The Estonian market is the most developed one in the Baltic countries. It is said that the mobile market is very dynamic and three operators compete for the market share. The net sales are also significant.

- In Denmark:

Table 4.13 TeliaSonera in Denmark

Net sales (SEK in millions)	Group holding (%)	Trademarks	Services	Number of customers	Market Share (%)	Main Competitors
7,178	100	Telia	Mobile	1,154,000	22	TDC, Sonofon, Debitel
		Telia	Fixed Voice	195,000	5	TDC, Tele2
		Telia, Telia Stofa	Cable TV, Datacom and Broadband	355,000	14*	TDC, Cybercity, Tele2

* Consumer broadband.

TeliaSonera is the second mobile operator in the Danish market, which is comprised by 5.4 million inhabitants. The Danish market offers on of the lowest prices in Europe. After the successful acquisition of the Danish Orange in 2004, TeliaSonera enhanced its mobile customers in 630.000 and its market share increased significantly.
In respect of the cable TV operator, the alliance between Telia Stofa is also the second main operator and was the first to offer wireless broadband connections to the homes. The company also reaches an important market share because of the ADSL services due to this alliance.

- In Norway:

Table 4.14 TeliaSonera in Norway

Net sales (SEK in millions)	Group holding (%)	Trademarks	Services	Number of customers	Market Share (%)	Main Competitors
7,481	100	NetCom, Chess	Mobile	1,651,000	34	Telenor, Tele2
		NextGenTel *	Datacom and Broadband	166,000	14	Telenor

* Acquired in June 2006

There have been three successful acquisitions in Norway. TeliaSonera, through the brands Netcom and Chess, is the second mobile operator. 400.000 new mobile costumers was the result of the acquisition of Chess, the third largest supplier of mobile services at the end of 2005. In respect of the acquisition of NetCom, the second mobile operator, the group achieved a profitable migration from the traditional fixed telecommunication to the mobile services.
They are also working in the sector of broadband since middle 2006 when the group acquired NextGenTel, the second market supplier in this sector. This firm works under its own brand, own development, sales and marketing providing services to its costumers like IP voices, IP TV and internet. Sales income reaches record levels.

- In Finland:

Table 4.15 TeliaSonera in Finland

Net sales (SEK in millions)	Group holding (%)	Trademarks	Services	Number of customers	Market Share (%)	Main Competitors
16,308	100	Sonera	Mobile	2,507,000	47	Elisa, DNA
		Sonera	Fixed Voice	647,000	31	Elisa, Finnet
		Sonera	Datacom and Broadband	426,000	32 *	Elisa, Finnet, HTV

* Consumer broadband.

The mobile market in Finland offers one of the lowest prices in Europe. However the Finnish fixed market is quite fragmented with a large number of local operators. Like in other markets fixed voice is decreasing whereas broadband services are increasing. Sonera provides a complete selection of services in fixed communication in the northern, eastern and south-western areas of Finland.

- In Sweden:

Table 4.16 TeliaSonera in Sweden

Net sales (SEK in millions)	Group holding (%)	Trademarks	Services	Number of customers	Market Share (%)	Main Competitors
38,960	100	Telia, Halebop	Mobile	4,387,000	52	Tele2, Telenor
		Telia	Fixed Voice	5,036,000	53 *	Tele2, Telenor
		Telia	Datacom and Broadband	1,439,000	41 **	Telenor, Comhem, UPC

* Traffic only. ** Consumer broadband.

TeliaSonera is the Swedish Telecom supplier under the brands of Telia, Halebop and Skanova. This market is one of the most developed in the world offering low prices due to a high competition. The group is leader in mobile telecommunication, fixed voice and data communication and broadband.
TeliaSonera focuses on the simplicity for the costumers. **"**Simplicity is key"[230]

4.4.3 Transaction

Characteristic of the operation

Telia offered 1.5144 shares in exchange for each Sonera share. Both companies' stock prices fell roughly since the merger was first announced in March 2002.[231] In December 2002, the merger between Telia and Sonera was completed.[232]

As we said above in the telecommunication industry, this is hard to accomplish. Both governments own majority holding in their respective operators (71% in Telia and 52.8% in Sonera) and under the merger deal the agreed to divest their respective stakes in five years.[233]

Purpose of the transaction

[230] Ingel Anders.President and CEO TeliaSoneraTelecommunication internacional edition. 1/2005, p. 19
[231] *"TeliaSonera merger prospectus announced"*. RCR Wireless News 7/10/2002
[232] Nigel Hawking, *"TeliaSonera"*. Utility Week 21/03/03, p. 24
[233]Ian Scale, *"Why Sonera/Telia could be an anomaly"*. America's Network 15/5/2002, p 23

After the failure attempt of merger with the Norwegian Telenor, Telia aimed at Sonera as a perfect target to expand itself. This combination, where Telia comprised around two third of the overall ebitda, involved the first big merger between telecoms companies in Europe.[234]

The idea was to become in a Nordic and Baltic powerhouse with many chances of expanding towards Russia. According to many observers, the move was the beginning of the long-awaited consolidation among incumbents.[235] There will be plenty of opportunities to grow both organically and by acquisitions.[236]

This industry expects firms to have higher ratios of margins in order to increase the profitability[237], instead of increasing Assets Turnovers as food companies for instance. We explained these ratios in the theoretical part of this study. It is expected to generate as much amount of operating income per unit of sales. Therefore, expanding trends in all over the markets in order to reach economies of scale to decrease marginal costs and cost per unit.

This industry is always very dynamic and challenging because the demand always expects something else, thus many innovation have been created in the last decade in the mobile sector in particular. Firms in this industry must face continuous changes like the current trend from fixed to mobile telecommunication.

A big position in this industry is important also due to the high competitiveness in prices and the large amount of resources that these companies must invest first before obtaining profits. We reference again the words of the president and CEO of TeliaSonera when he mentioned that the purpose of the company is to be the first or the second player in the markets where operating. If you are the third one, to be the closest to the second in order to have chances of being one of the big players.[238]

The new company became in the major force in the Nordic telecoms sector. TeliaSonera's main growth area was in 2003 the mobile sector. Telia raised its Ebitda margin to 50 per cent in Sweden and Sonera was established itself in Finland where the mobile industry is very strong, dominated by the world's leading mobile phone manufacturer, Nokia.[239]

Approaching the merger

In the third quarter of 2002 Telia reported a jump of 25 per cent in EBITDA (Earning before interest, tax, depreciation and amortisation) to £296 million and therefore an increase in margin from 24 to 30 per cent. According to the analysts, these positive indicators raised the chances of success for Telia's £3.43 billion bid for Sonera. Sonera shareholders were thought to accept the offer in all likelihood. However these ones are not the only indicators. Net sales increased marginally to £1 billion. Operating Income

[234] Nigel Hawking, *"TeliaSonera"*. Utility Week 21/03/03, p. 24
[235] Ian Scale, *"Why Sonera/Telia could be an anomaly"*. America's Network 15/5/2002, p. 23
[236] http://www.teliasonera.se/ April 25, 2007
[237] Stephen H. Penman. *"Financial Statement Analysis & Security Valuation"* (2003), p. 360
[238] http://www.teliasonera.se/ April 25, 2007
[239] Hawking, Nigel. *"TeliaSonera"*. Utility Week 21/03/03, p. 24

fell into loss of £745 million after paying out more than £1 billion in order to restructure its international carrier operations and its fixed network in Denmark.[240]

In this respect Anders Igel, President and Chief Executive Officer, said: *"The significant increase in the underlying Ebitda margin combined with reduced investments resulted in a sharp increase in free cashflows"*

Telia offered just over 1.5 shares for each Sonera share. The US financial regulator and the Stockholm stock exchange were involved of approval the bid. Previously Finland's financial regulator said that the takeover could proceed after accomplishing some criteria. European Commission from Brussels established several regulations before approving the bid:[241]

> - Telia has to sell its mobile operations, dealership chain, wireless LAN business in Finland.
> - Telia has to get rid of its Swedish AB telecom business and its related network.
> - The new company has to ensure that its fixed and mobile businesses are developed in different legal entities and distinct from related retail activities.
> - The new firm has to establish its regulated wholesale fixed and mobile product available to other operators in both markets on a non-discriminatory basis.

In the other hand, Telia said that would give the bid up if 90 per cent of Sonera's shares were not offered for exchange[242]. With this, the reader can obtain an idea of what a complicated operation was carrying out.

Expected results

The Swedish company evaluated that total transaction costs were expected to be $132.2 million, where $50.9 million of that amount were allocated for the Finnish transaction tax. The other costs were banks fees, legal services, auditors, prospectus preparations, printing, distribution, shareholders information and stock exchange fees.[243]

During the merger, remuneration plans were expected and it was said that about 70 managers and key Telia personnel would be affected.[244]Furthermore, about 400 jobs were expected to be cut in the Finish part right after the merger, the second quarter of 2003. In respect of the Swedish part there was no number of layoffs. [245]

The company agreed to use Telia, as brand in Sweden and Denmark, Sonera in Finland, and NetCom in Norway. The combined company became the largest operator in Sweden and Finland, the second largest and the fourth largest one in Norway and Denmark respectively.[246]

In respect of what it was expected in the market, there were many opinions that placed TeliaSonera between the biggest players in Europe. According to Julian Rawle, a senior

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[240] *"Telia´s EBITDA soars and aids Sonera bid"*. Utility Week 1/11/2002, p. 13
[241] Telecommunication/International Edition Aug 2002, p.14
[242] *"Transaction costs"*. RCR Wireless News 14/10/2002
[243] Ibid
[244] Ibid
[245] *"TeliaSonera announces job cuts"*, RCR Wireless News 7/4/2003
[246] *"TeliaSonera merger prospectus announced"*. RCR Wireless News 7/10/2002

market analyst for The Yankee Group, *"we are going to see a polarization in Europe in the next five years where only a few carriers are controlling all European markets."* He concluded affirming that he could see easily TeliaSonera between those few carriers.[247]

Furthermore, no major problems were expected with respect to the mobile manufacturers. Traditionally, Telia and Sonera were closer to Ericsson and Nokia, respectively. Vendor loyalty was not expected to be a negative factor during the merger process, according to the analysts.[248]

It was expected that the company achieved cost saving due to the economies of scale and its expanding policy. This was required to be demonstrated for the success of the merger especially in the first year after the merger.[249]

A stronger position in the European market was expected to be accomplished and new opportunities in the industry would be studied from the leader's point of view. For example the Spanish case where TeliaSonera is focusing nowadays its strategy of expanding. The Spanish mobile sector has been dominated by three operators Telefonica (46%), Vodafone (30%) and Amena (24%), acquired by France Telecom in 2005, which explains the difficulty of enter into this market. However TeliaSonera is big enough to confront the challenge of entering into this market.

According to Anders Igel, president and CEO of TeliaSonera, *"the market conditions in Spain give room for another player. This, together with decreasing vendor prices as well as availability of good quality and reasonably priced 3G terminals provide the opportunity to establish ourselves in a new market."* However, according to Morten, director of telecom research at West LB in London, *"TeliaSonera may intend to act as a 3G wholesaler but the lack of national coverage could be a stumbling block to that and the rewards look slim for what is quite a high risk investment."* [250]

Real results. Was the merger a success?

Telia was twice as large as Sonera and Telia´s shareholders controlled 64 per cent of the group.[251]After the merger the company is larger and its market share has been increasing in the most of the markets where they operate. The position on the respective countries has improved or held comparing data in 2002/2003 to the data obtained from the tables above mentioned in 2005.

In a merger is very important to take into account the credit rating before and after the merger. Standard & Poor´s announced that the credit rating for TeliaSonera was A, whereas Telia's former credit rating was A+ and Sonera´s one BBB. Thereby no important change was generated due to the merger.[252] The higher the credit rating is, the lower the borrowing cost.

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[247] *"TeliaSonera. Merger walks Regional Political Tightrope"*. Fitchard, Kevin. Telephony 1/4/2002
[248] *Ibid*
[249] Nigel Hawking, *"TeliaSonera."*. Utility Week 21/03/03, p.24
[250] Taaffe, Ouida. *"TeliaSonera backs Xfera but at what costs?"*Telecommunications International Edition.
[251] Kevin Fitchard, *"TeliaSonera. Merger walks Regional Political Tightrope."* Telephony 1/4/2002
[252] *"TeliaSonera announces mandatory redemption results"*. RCR Wireless News 2/10/2003

As the president of TeliaSonera said in respect of the layoffs,*"We have to secure our competitiveness and our capability to offer our customers value-for-money products*" [253] The number of layoffs in 2003 was 549 and 376 occupation were redundant but these costs were offset with a provision of SEK 341 million made the same year .[254]

TeliaSonera is one of the leading telecommunication providers in Europe. Economies of scale and brand image are advantages of this leadership position but we want to develop a small SWAP analysis in order to understand the success of the company after the merger by observing the strengths and weaknesses of the firm and the opportunities and threats of the industry.[255]

- Strengths:

  -Market leadership (market share)
  -Strong revenue growth and returns
  -Increasing 3G subscribers

- Weaknesses:

  -Declining EBITDA after merger[256]
  -Weak performance in Sweden and Finland

- Opportunities:

  -European residential internet market
  -Growing Russian and Turkish markets
  -Introduction of new services like MSN over 11 million mobile costumers

- Threats:

  -EU regulation on international roaming
  -Telecom consolidation
  -High mobile penetration in key markets

We want to explain in details some data from the SWAP analysis in order to compare them before and after the merger. In respect of the TeliaSonera's revenues growth and returns, they have been increasing during 2001 and 2005. Due to the synergies derived from the company, the company's revenue growth was 10.2 per cent, whereas the industry average was just 6 per cent, which indicates that the group has been successful in expanding its market share. [257]

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[253] *"TeliaSonera announces job cuts"*, RCR Wireless News 7/4/2003
[254] http://www.teliasonera.se/ April 25, 2007
[255] TeliaSonera AB SWOT Análisis; Datamonitor Aug 2006, p. 1-8
[256] Note that this data in the opposite compared to the 11 % increased EBITDA from the table of the TeliaSonera website but as explained in the limitations of this study, they refer to as EBITDA excluding non curring items
[257] TeliaSonera AB SWOT Análisis; Datamonitor Aug 2006, p. 1-8

As we have already developed the returns in the theoretical part, we just mention another data by comparing TeliaSonera and the industry: [258]

Table 4.17 RNOA TeliaSonera compared to the industry

RNOA	2001	2005
TeliaSonera	3.6%	4.6%
Industry	1.4%	2.0%

The number of 3G subscribers in Sweden grew by 75 per cent during 2005 reaching 1.4 million. The company's data traffic enhanced a 300 per cent during 2004.

The synergies are a key factor when merging. In this case, a successful integration is accomplished. The main features extracted from the next table can be summarized as:[259]

-reduced costs
-lower CAPEX
-more rapid service development

Table 4.18 Synergy saving

Synergy saving from decision to date (SEK million):

SEK Million	**Full run rate annual effect by 2005**	**Effect by 2003**
OPEX		
Product and service development	529	205
IT system and infrastructure	276	100
Purchasing	303	254
Network operations	490	178
Corporate functions	153	145
TOTAL	**1,751**	**882**
CAPEX		
Product and service development	13	46
IT system and infrastructure	22	53
Purchasing	324	358
Network operations	15	34
TOTAL	**374**	**481**

Many other positive numbers can be taken in consideration to support the success of the merger. After which, TeliaSonera increased its market share in the mobile communication sector in all the markets where the group is operating in. TeliaSonera reached 12 million mobile costumers in its consolidated operation and 26 million in

[258] TeliaSonera AB SWOT Análisis; Datamonitor Aug 2006, p. 1-8
[259] http://www.teliasonera.se/ April 25, 2007

associated companies at the end of 2003, which meant a huge enhancement compared to the last year.[260]

Despite the price pressure that we mentioned in the first paragraph of the introduction of TeliaSonera in the telecommunication industry, group net sales increased 1 per cent to SEK 81,772 million from SEK 80,979, as we can see in the 2003 financial report.[261]

Table 4.19 2003 financial report

In million except percentages and per share data	**Oct-Dec 2003 SEK**	**Oct-Dec 2002 SEK**	**Jan-Dec 2003 SEK**	**Jan-Dec 2002 SEK**	**Jan-Dec 2003 EUR**
Net sales	21,054	20,945	81,772	80,979	9,010
EBITDA	7,143	6,355	30,690	25,457	3,382
Margin (%)	33.9	30.3	37.5	31.4	37.5
Income for associated companies	499	368	382	-33,039	42
Operating Income	3,382	46	13,140	-45,958	1,448
Operating Income excluding non-recurring items	3,330	2,150	14,831	5,992	1,634
Income after financial items	3,100	-80	12,346	-46,791	1,360
Net Income	2,696	3,008	7,671	-32,890	8,45
Earning/Loss per share	0.58	0.64	1.64	-7.03	0.18
CAPEX	3,336	3,360	8,960	11,710	987
Free cash flows	3,309	3,672	17,499	9,534	1,928
Legal					
-Net sales	21,054	16,756	82,425	59,483	9,082
-Net income	2,696	1,894	9,080	-8,067	1,000
-Earning/loss per share	0.58	0.54	1.95	-2.58	0.21

Pro forma presentation as if the merger of Telia and Sonera had taken place on January 1, 2002
and excluding Telia's Finnish mobile operations and Swedish cable TV operations.
Including Sonera operations and the new Baltic subsidiaries since December 3, 2002 and
Telia's Finnish mobile operations and Swedish cable TV operations through May 31, 2003.
conversion rate SEK 1 = EUR 0.110183

However price changes and exchange rate fluctuation are responsible of the slight negative effect on sales. Although, focusing on the fourth quarter of 2003 and 2002, when merged, we notice in the 2003 financial report that many items, like decreased good-will as well as deferred tax assets and liabilities in the balance sheet were adjusted. Moreover, operating income increased by SEK 291 million, income taxes expense decreased by SEK 113 million and thus, net income raised by SEK 178 million.[262]

Free cash flow generated in 2003 and in the next period reached a record of SEK 17,499 million from SEK 9,534 million, which enabled the firm to reduce net debt from SEK 19,868 million to SEK 18,207. A healthy situation enabled the group to make a reserve fond for future disbursements at year-end recorded SEK 3,093 million. Some reasons for this improvement in free cash flows are the low cash taxes and the group, according to the European Commission resolution, divested Telia Finans AB yielding cash inflow

[260] http://www.teliasonera.se/ April 25, 2007
[261] http://www.teliasonera.se/ April 25, 2007
[262] http://www.teliasonera.se/ April 25, 2007

of SEK 6.2 million or other sales like Com Hem and Telia Mobile Finland. Consequently, TeliaSonera´s financial position improved approximately SEK 2.3 million.[263]

Moreover, outside the two home markets, the group must face various problems. In particular in Denmark Telia, after the merger, is not improving in breaking into the Danish market. It is also possible that Sonera was expanding too fast and the expected levels of proceeds on its non-telephone businesses are not happening yet. Its Turkcell idea in Turkey is performing below expectations.[264]

According to Anders Igel, "*We are proud of our achievements in 2003 with a record profit, integration of Telia and Sonera accomplished…*"[265]Considering all the differences and factors that companies must face in a merger, and taking into account that in this case we are talking about big companies, which so far, almost five years after the merger, as a group, is doing well in general. No recent information about TeliaSonera´s performance in the Swedish index will be taken into account.[266] Thus, we can affirm that the merger is a successful case.

4.4.4 Telia Telenor

Before continuing with the discussion of the propositions, we quickly want to mention some aspects that we consider interesting within the failure attempt of merger between Telia and Telenor in 1999. We will focus on the main features that explain why the merger did not even take place. We will obtain some finding in this small case which will complete the analysis of the propositions of TeliaSonera in the next section (4.4.5)

Characteristic of the operation

On 1999, January the 20th they announced the merger. The merged company was called Telaris. Two different size firms were willing to merger in a complicated scenario full of public and national interest where the aggressive media were a significant factor in the final failure[267]

Purpose of the transaction

The merger would have become the sixth largest European telecom with a market value close to $50 billion[268]. As we explained in TeliaSonera, that would have created many synergies and saving costs required in this industry to become a big player or a leading role in different markets.[269]

"The main goals were related to the strategic target", according to Richard Tolkien, a managing director at HSBC and a Telenor´s adviser. As in TeliaSonera, European and

[263] http://www.teliasonera.se/ April 25, 2007
[264] Nigel Hawking, "*TeliaSonera"*. Utility Week 21/03/03, p.24
[265] http://www.teliasonera.se/ April 25, 2007
[266] http://df.se/ April and May/ 2007
[267] "*Telaris: The merger that never was"*. Drexhage, Clem. Corporate Finance. Feb 2000, p. 22
[268] "*TeliaTelenor merger collapses*". RCR 20/12/1999, p.6
[269] "*Telaris: The merger that never was"*. Drexhage, Clem. Corporate Finance. Feb 2000, p.22

global expansion, increased profitability and the development of international business areas were the common objectives.[270]

Expected results

According to Philip Carse, a telecom analyst at Salomon Smith Barney, pointed the deal as an agreement between two small firms into a greater player that would be able to compete more effectively in Scandinavian and global markets. Telenor was employing more than 19,000 and Telia comprised more than 30,000. Telenor revenues were about NKR 25 million ($3.1 billion), whereas Telia´s turnover was SEK 51.2 billion ($6 billion)[271]

The annual revenues were estimated to be about SKR 79 billion and the company was expected to success in the high tech areas such as mobile communications, satellite communication and the Internet.[272]

Real results. Was the merger a success?

This was not the first time that these firms tried to merge. They had already attempted two years before. The second opportunity occurred in January 1999. Both parties signed a letter where they agreed to merger the firms. The powerhouse chosen was Stockholm, in Sweden and registered in the same country and the Norwegian Tormod Hermansen, Telenor´s CEO, was the top manager. The Swedish government and the Norwegian one would own the new entity 60 and 40 per cent respectively.

Later in December, they broke the agreement for several reasons related mainly with the location of the merged company mobile unit and the lack of trust between each other. The merger did not work and $29.5 million were the estimated combined costs, according to a joint statement from the Swedish and Norwegian government which were 100 per cent owner of the respective companies, at that time.[273] Consequently we talk, in this case, about a failure merger attempt.

Why was the merger a failure?

It was difficult to implement two state-owned firms. Some observer always criticised that Telenor´s CEO Tormod Hermasen negotiated on both a corporate and a political level with the blessing of the Norwegian government.[274] Moreover, two state-owned companies will be in the spotlight, which became a delicate matter in public affair.

Another mistake, which will be used later as a finding to improve the current theory, is to structure the transaction or deal as a merger of equals. Telia and Telenor disagreed in the location of the mobile phone unit, which became an issue of national pride discussed for weeks. Consequently it is easy to think more in matter of control than in growth opportunities for the group, "*do you think that America Online and Time Warner (record-breaking $327 billion merger) thought very much about whether the value split*

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[270] "*Telaris: The merger that never was*". Drexhage, Clem. Corporate Finance. Feb 2000, p.22
[271] Ibid
[272] Ibid
[273] Ibid
[274] Ibid

was 60-40 or 61-39? No, they didn´t care. They just did it because they knew there was going to be huge value creation.” [275]

The third reason that we want to highlight is related to a issue of lack of communication and trust. According to Backman from Telia, *“owners had a different perception of the meaning of the shareholders´ agreements.”* The shared vision was damaged after many misunderstandings between both parties, many elements that can not be observed in balance-sheets calculations.[276] According to Tormod Hermansen, CEO of Telenor talking about ideal condition of trust for the success of the merger, “*when one party clearly demonstrates that these conditions are no longer decisive, then unfortunately the whole basis for the thesis is gone.”* [277]

Consequences

After a failure, reputation of doing business falls. According to Tormod Hermansen, Telenor´s CEO *“there have been recent questions about our ability to fulfil transactions like this merger and we will do our best to repair this questioning”*[278]

4.4.5 Results of TeliaSonera

Why was the merger of TeliaSonera a success?

Proposition 1: Less cultural differences will be positively associated to successful implementation.

Both companies belong to the same industry and both of them have followed similar tracks as we could see when we introduced the firms. They were homonyms in Sweden and Finland respectively.

Despite their different size (Telia is larger than Sonera), they have successfully implemented as a whole. Several meeting in order to provide information to its shareholders are usually carried out in English[279], both in Sweden and in Finland. By using this language, both parts become closer and they easily understand each other because traditionally, English has been popular in this area due to the fact that Swedish and Finish languages are small.

These countries have different cultures. People in their respective countries show a high degree of rivalry each other. However they share some important features like the way of living or doing businesses, being both countries friends of the development, with a high index of finding and innovative products helped with a powerful technology. Both economies are between the richest in the world and their inhabitants have one of the highest incomes per capita.

Consequently, this features and the desirability of the merger by both parts result in concordance to be successful in the transaction.

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[275] *“Telaris: The merger that never was”*. Drexhage, Clem. Corporate Finance. Feb 2000, p.22
[276] *Ibid*
[277] “*TeliaTelenor merger collapses”*. RCR 20/12/1999, p. 6
[278] *“Telaris: The merger that never was”*. Drexhage, Clem. Corporate Finance. Feb 2000, p. 22
[279] Kevin Fitchard, *“TeliaSonera. Merger walks Regional Political Tightrope”*. Telephony 1/4/2002

In the other hand, we have talked about TeliaTelenor and its failure attempt of merging. We can see here the negative aspect of the cultural differences. Norway was a former colony of Sweden and now they are really proud of its independence. This relationship is often compared as the one between Canada and USA. Sweden has a established market tradition (Ericsson, Volvo) whereas Norwegian industrial sector is smaller with a image of a nation suspicious of foreign takeovers. According to Christian Hambro, a top executive manager at the Norwegian Research Council explained that *"it is fair to say that Sweden has a more mature attitude to globalization than the one you have in Norway"* and he concluded arguing that Norway still need to accept the implications of globalization.[280]

Proposition 2: No post acquisition planning will be negatively associated to successful implementation.

The merger was announced in March and finally carried out in December 2002. In this process both parts agreed in a common expand strategy and they knew what to do after the merger, sharing businesses and improving their position over the different markets. Telia would increase their businesses, reaching more consumers and Sonera would improve its credit rating for instance.

Proposition 3: Lack of knowledge of industry or target firm will be negatively associated to successful implementation.

Both firms had a wide knowledge in this industry. They had similar history and both were owned in majority by their respective governments before the merger[281]. They shared the target of expanding before and after the merger.

Proposition 4: No prior acquisition experience will be negatively associated to successful implementation.

This is one of the most important factors. Telia learnt of former operations. The last failure attempt with Telenor in 1999[282] provided the group with useful knowledge for the success in the next transactions.

Proposition 5: Following a wrong strategy will be negatively associated to successful implementation.

The governments agreed in divesting their respective holdings in five years. They considered this strategy to be the best possible. We have found data that indicates in 2003 lower holdings by the governments in 2003. The Swedish state owned 45.3 and the Finnish just the 19.1 percent of the share capital.[283]

Proposition 6: Not considering other alternatives to merger or acquisitions will be negatively associated to successful implementation.

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[280] *"Telaris: The merger that never was"*. Drexhage, Clem. Corporate Finance. Feb 2000, p.22
[281] http://www.teliasonera.se/ April 25, 2007
[282] Kevin Fitchard, *"TeliaSonera. Merger walks Regional Political Tightrop"*. Telephony 1/4/2002
[283] http://www.teliasonera.se/ April 25, 2007

Proposition 7: Overestimation of potential synergies is related to less successful implemented M&A.

Some problems like layoffs and cultural tensions arise when merger with another company and this fact can minimize expected synergies. But in general, as explained before, TeliaSonera is performing well in the majority of its businesses with a solid strategy.

Synergies have carried out faster than expected yielding annual cost savings of SEK 1,751 million and annual capital expenditure saving of SEK 374 million at the end of 2005, while during 2003 both data reached just SEK 882 million and SEK 481 million respectively.[284]

Proposition 8: Higher premiums are related to less successfully implemented M&A

Proposition 9: Wrong management of the integration is related to less successfully implemented M&A.

Managerial team is experienced in this kind of businesses and the top managers have been working for the company several years. Managers from both companies are involved with the group.[285]

Proposition 10: Ignoring customers during the integration will lead to less successfully implemented M&A

This one is one of the quotes by Anders Ingel, president and CEO of the group, already mentioned above when he highlighted that TeliaSonera is working to its costumers in order to make their life simpler. One of the main purposes of the acquisition was to be able to make customer's life simpler.

Proposition 11: Not examining the financial position of the acquired company will lead to less successfully implemented M&A.

Both credit ratings were health as a summary of all the financial data in Telia and Sonera respectively. Both companies worked hand by hand with investment banks in order to make sure about the financial strength of both companies. [286]

Proposition 12: Incomplete or inadequate due diligence will lead to less successfully implemented M&A.

Proposition 13: Implementations made quickly will be associated to successful implementation.

Maybe this is their weak point. Implementation is not developing very fast but the group shares common goals in its four main business areas:[287]

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[284] http://www.teliasonera.se/ April 25, 2007
[285] Kevin Fitchard, "*TeliaSonera. Merger walks Regional Political Tightrop*". Telephony 1/4/2002
[286] TeliaSonera announces mandatory redemption results. RCR Wireless News 2/10/2003
[287] http://www.teliasonera.se/ April 25, 2007

- Mobility services
- Broadband services
- Integrated enterprise services
- Euroasia, because of the profitability for its shareholders. Recently Spain since 2006 is key in TeliaSonera´s expansion.

The timing was important for them but the managers of both companies gave much more importance to accomplishing the goals.

According to some observers, TeliaSonera is doing too aggressive in its expanding policy like in the Spanish case of Yoigo[288] and in Turkey with Turkcell.[289]

Proposition 14: Clarity of acquisition purpose will be associated to successful implementation.

According to Anders Igel, *"any acquisition must be value enhancing by fulfilling our financial return requirements and allow us to maintain a solid position"*[290]

The merger between Telia and Sonera fulfilled with this purpose, since it improved the financial position and the market power.

Proposition 15: High degree of target management co-operation will lead to successfully implemented M&A.

Managers´ remuneration is not as high as expected in this kind of companies. Traditionally Sweden and Finland are characterized by small differences in wages from the CEO to a regular employed. This is a good indication where their common objectives are more weight than the individual ones. Thus, if the company works, everyone feels responsible. At the same time the managerial co-operation is bigger because the important issue is the company prior the individual objectives.[291]

Consequences

- Problems with the unions

Confirming the theoretical part about returns, we consider again Anders Igel´s words when he said in the TeliaSonera 2003 shareholders´ report that *"any acquisition must be value enhancing by fulfilling our financial return requirements and allow us to maintain a solid position"*[292]As we have mentioned, cultural differences when merger with another firm is a key factor. It is probably that TeliaSonera is a rare case of merger within important telecoms operator and due to this fact of cultural reason we will not see quite combination of this kind in the future. *"The main barriers to incumbent consolidation in Europe is probably just good old-fashioned nationalism"*, [293] but it looks like Swedish and Finnish will outcome this traditional barrier in Europe.

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[288] Ouida Taaffe,.*TeliaSonera backs Xfera but at what costs?* Telecommunications International Edition.
[289] Nigel Hawking, *"TeliaSonera"*. Utility Week 21/03/03. Pag 24
[290] http://www.teliasonera.se/ April 25, 2007
[291] http://www.teliasonera.se/ April 25, 2007
[292] http://www.teliasonera.se/ April 25, 2007
[293] Ian Scales, *"Why Sonera/Telia could be an anomaly"*. America's Network 15/5/2002, p. 23

In this respect we have seen many opinions everywhere but they can be summarized with the followings quotes. According to Camille Mendler, director of fixed telecom for The Yankee Group, *"there are a lot of cultural tensions that exist between all the European countries and they date back centuries"* and referring to TeliaSonera, in particular, he said that *"how they address those tension will determine if this merger is a success"*[294]

Does the case correspond with the theory?

Table 4.20 Propositions compared to the theory. Telia Sonera and Telenor.

[294] TeliaSonera. *"Merger walks Regional Political Tightrope"*. Fitchard, Kevin. Telephony 1/4/2002

Existing Theory	It corresponds with the theory
-Less cultural differences will be positively associated to successful implementation.	YES
-No post acquisition planning will be negatively associated to successful implementation.	YES
-Lack of knowledge of industry or target firm will be negatively associated to successful implementation.	YES
-No prior acquisition experience will be negatively associated to successful implementation.	YES
-Following a wrong strategy will be negatively associated to successful implementation.	YES
-Not considering other alternatives to merger or acquisitions will be negatively associated to successful implementation.	NO DATA FOUND
-Overestimation of potential synergies is related to less successful implemented M&A.	YES
-Higher premiums are related to less successfully implemented M&A	NO DATA FOUND
-Wrong management of the integration is related to less successfully implemented M&A.	YES
-Ignoring customers during the integration will lead to less successfully implemented M&A	YES
-Not examining the financial position of the acquired company will lead to less successfully implemented M&A.	YES
-Incomplete or inadequate due diligence will lead to less successfully implemented M&A.	NO DATA FOUND
-Implementations made quickly will be associated to successful implementation.	YES
-Clarity of acquisition purpose will be associated to successful implementation.	YES
-High degree of target management co-operation will lead to successfully implemented M&A	YES

The findings of the case correspond with the existing theory.

5. REVISION OF THE THEORY

During this part, we will compare the findings of the different case studies with the existing theory, and we will present the new findings we have discovered that were not previously considered by other authors. This part represents the answer for our initial research question.

5.1 Cross-case study of the former propositions

- Proposition 1: For all those cases which we have found information, the findings support the previous theory. We can conclude that less cultural differences between two companies lead to a more successful implementation process.

- Proposition 2: All the information found support the previous theory. No post acquisition planning is negatively associated with negatively managed implementation process.

- Proposition 3: We have found information related to this proposition in all the cases, and all the findings support the previous theory. We conclude that a lack of knowledge of the industry or the target firm is negatively associated to a successful implementation of the merger or acquisition.

- Proposition 4: In three of the four cases we have studied, the findings are related with the previous theory, but in the case of Quaker Snapple the findings do not correspond with. As we said during the third part of our thesis, this does not mean that the theory is wrong, due to the fact that these findings are difficult to generalize. However, we think that these findings should be taken into account because they can be of great interest for other companies.

- Proposition 5: All the findings correspond with the theory. Following a wrong strategy is negatively associated to successful implementation.

- Proposition 6: We have found information related to this point in half of the cases and in both of them the findings support the existing theory. Not considering other alternatives to merger or acquisitions is negatively associated to successful implementation.

- Proposition 7: In all the cases we have found information about this issue and in all of them, there was one of the most important reasons for the success or failure of the acquisition. All the information found support by the theory, and this is why we can conclude that overestimation of potential synergies is related to less successful implemented M&A.

- Proposition 8: It was explained within the theoretical part that, according to most of the authors, higher premiums are related with less successful implementation of M&A. However, as we pointed out in the same part of our study, some other authors advocate the idea that higher premiums are not always related to less successfully implemented M&A. For those cases we have found information, higher premiums are related to less successfully implemented M&A.

- Proposition 9: Many authors agree that wrong management of the integration is related to less successfully implemented M&A, and the cases, that we have analyzed, support this theory.

- Proposition 10: All the information support the idea that by ignoring customers during the integration lead to less successfully implemented M&A

- Proposition 11: Not examining the financial position of the acquired company lead to less successfully implemented M&A, according to our findings.

- Proposition 12: According to our cases incomplete or inadequate due diligence lead to less successfully implemented M&A.

- Proposition 13: All the data support the idea that implementations made quickly are associated to successful implementation.

-Proposition 14: Clarity of acquisition purpose is associated to successful implementation.

- Proposition 15: High degree of target management co-operation lead to successfully implemented M&A

5.2 New findings

- Monitoring the progress of the integration: In the cases of BP Amoco and Stora Enso, this point was one of the reasons for the successful implementation of the merger or the acquisition. Due to the fact that there was no theory related to this point, we will formulate a proposition that would be interesting to be discussed by other authors: Monitoring the progress of the integration will be associated to successful implementation of the merger or acquisition.

- Personal interest of the CEO: As we saw during the Quaker Snapple case, the personal interests of the CEO of the company can be a reason for the failure of a merger or an acquisition, especially when these interests are against the shareholders´ ones. The proposition that must be researched is: CEOs, who moved by personal interests, might be the reason for a less successful implementation of a merger or acquisition.

- Importance of the mission, vision and values for the unification of the company: Formulation of the mission, vision and values by all the key employee of both companies can be of great value for the integration of both companies. The proposition that must be considered is: Formulation of a mission, vision and values by the key employees of both companies will lead to a successful implementation of the merger or acquisition.

- State-owned companies can face more difficulties for merge due to the nationalism of the different countries, as we explained through the Telia Telenor case. The proposition that would be interesting to analyze by other authors is: State-owned companies have more difficulties for a successful implementation of the merger.

- As we have seen through the cases of Quaker Snapple and Telia Telenor, the bigger the different in size is, the higher the chances of failure or disagreement. The proposition that should be studied by other authors is the next: A higher difference between the sizes in both companies will lead to a less successful implementation of the merger or acquisition.

6. CONCLUSION

During this part, we will present our conclusions. Please, note that the specific answer to the research question is made during the part five of our thesis.

6.1 Research question

We want to quote for the last time our research question, which we have been trying to answer throughout all this study.

Why do the majority of merger and acquisitions fail?

6.2 Answer to the research question

Even though the majority of mergers and acquisitions fail, in the last years the number of mergers and acquisitions has increased extraordinarily. After our research, we have found that the main reason why companies merge or acquire other firms is the changes in the industry where they are playing in. For example, the acquisition of Amoco by Bp and the Stora and Enso's merger took place in order to solve the problems of the maturity of their respective industries. In the other hand, the merger between Telia and Sonera occurred in order to become a bigger player in an industry where being global is going to be a matter of survival.

There are many reasons for the failure of an acquisition. Throughout the theoretical background part we have presented the main reasons for this failure. We also have checked if those reasons were relevant for each one of these cases by following a comparative design between different case studies.

We have added new findings to the results. This issue is important for us since we have developed this study with the main idea of finding new propositions which can be interesting and useful for other students or firms. We can finish by saying that we are satisfied with our research because we have reached our goals of contributing to develop the archival theory and we believe that we have covered a good part of the issues that involve mergers and acquisition. Further studies can be used to support this one but, at least, we see the theoretical part as a good briefing to order all the ideas around this topic.

6.3 Recommendation for future studies

First of all we would like to recommend further studies in order to test if the new findings we have found can be generalized to other companies.

We also think that it would be interesting to conduct further studies in order to find some new reasons for the failure of the merger or acquisitions. For example, in mergers and acquisitions, we think that it might be interesting to investigate the role of the investment banks in the failure or success of the transaction. We have been inspired in this possible new research question after realizing how complex the world of mergers and acquisitions is.

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