by Eric Uhlfelder

Transatlantic crossings

Seen as a panacea for limited growth prospects at home, recent European takeovers of US firms are encountering management problems. CEOs should be wary of the pitfalls.

Academic studies consistently show that most mergers and acquisitions fall short of expectations, if they don't actually fail. So what does that mean for the recent spate of European companies who have been gambling billions of euros, pounds and kronas, acquiring US assets?

The evidence so far is not encouraging. While few companies are willing to discuss their experiences in detail, interviews with analysts, corporate insiders and consultants suggest that the high profile problems of the best known transatlantic marriage – DaimlerChrysler – are far from unique. According to Gerald Adolph, a Booz Allen senior partner in charge of merger integration, two-thirds to three-quarters of all European acquisitions in the US have either failed to enhance shareholder value or help realise company expectations.

During the late 1990s as stock markets were moving relentlessly upwards, few observers seriously questioned Europe's western expansionism. Such activity appeared to be part of the natural order of an increasingly global market place. As a Deutsche Bank executive put it, 'what else can European firms do to energise stature and performance that matches a US takeover?"

It is still possible, of course, that some troubled European acquisitions will ultimately realise long-term benefits – but the current track record begs two basic questions;

Why have major continental players become so obsessed with taking over US businesses in the first place, and should CEOs and investors of acquisitively-minded European companies rethink their positions?

Experience suggests a number of operational and financial risks. The way in which Chrysler's collapse has wrecked havoc over Daimler's healthy finances has been well documented. SAP's incursion into the US, meanwhile, forced the company to offer options to all its upper management – a gesture that had chewed up a good deal of its profits. AEGON has been unable to dump the sizable non-life

assets of Transamerica, exposing it to a riskier side of the insurance industry from which it's worked so hard over the past decade to rid itself. And the enthusiasm of analysts for Adecco – acquirer of two major US employment agencies – has been qualified by the Swiss company's failure adequately to report the breakdown of revenues and profits by geography, a shortcoming which makes it very difficult to assess the effectiveness of the company's aggressive global deal-making strategy.

"Deals with US firms can be challenging for Europeans due to the speed at which US managements are accustomed to making decisions – perhaps because there is less protocol and formality embedded in the corporate culture of many companies relative to their European counterparts", says Denis Picard, a PwC partner based in New York who specialises in M&A integration and cross border transactions. US acquirers, he points out, consistently

Figure 1: European acquisitions of US companies; 1994-2000

relocate and devote key management resources to offshore acquisitions for the purpose of integrating the target into the US company, conforming reporting and processes, increasing and defining desired levels of communication and sharing corporate culture locally. Many deals by European acquirers in the US are not so much flawed because of the business case or strategy as by communication and cultural differences.

This article reviews some of the major issues involved in integrating US assets, thereby challenging European executives to more candidly reflect on the true costs and risks of embarking on US takeovers.

Looking westward

The transatlantic takeover numbers are indeed staggering. According to data provided by Thomson Financial Securities there were more than 3,900 European acquisitions of US firms between 1994 and July 2001. Deal-making has been especially frenetic since 1997, increasing by 26 per cent a year and peaking in 2000 with 884 European takeovers of US firms worth $242bn (see Figure 1).

Europeans have spent more than $878bn since 1994. That represents nearly 73 per cent of the total value of all foreign takeovers of US firms. The average European deal was $224m, 60 per cent greater than the average foreign acquisition of a US firm.

Furthermore, there has been a prevailing westbound current in transatlantic deal-making, with Europeans having spent more than twice the amount US firms spent buying European assets. Little wonder why the US dollar has been so strong.

British firms have been the most aggressive buyers, having spent $380bn, followed by German and French companies ($143bn and $110bn respectively) over the past seven and a half years. Dutch and Swiss companies have also been moving actively into the US with investments of $100bn and $63bn, respectively.

Telecommunications deals have dominated the M&A scene since 1994 (see

Table 2) accounting for 13 per cent of all transactions and led by Vodafone's $66bn takeover of AirTouch Communications in 1999. The next most active sector has been oil, gas, and petroleum refining, amounting to $97bn, though more than half was generated by British Petroleum's purchase of Amoco at the end of 1998 for $55bn.

Next came Business Services ($59 bn) where the French firm Cap Gemini pulled off the largest deal, acquiring the consulting business of Ernst & Young for nearly $12bn in 2000.

Reasons for defying the odds

Acquisitions are typically inspired by one of three fundamental reasons, according to David Allen, chairman of SFM Ltd and a former president of the Institute of Management Accountants. There is the desire to expand into larger markets and to exploit the expertise and technology of the target company; the defensive need to protect and expand one's own domain in response to deregulation, the easing of takeover rules, and other pressures towards market consolidation; and the search to reduce risk by, say, diversifying production sites and matching currencies associated with manufacturing costs with those generated from sales.

From the European perspective, a series of EU open market accords, the adoption of the euro, and a more transparent Europe have all been drivers of rationalisation throughout the 1990s. Additional factors promoting acquisitions include:

- **The desirability of US assets**
  Europeans have been coveting American firms because of their perceived superior product and management efficiency, labour flexibility, and strong domestic market growth. They have been particularly active in Silicon Valley where acquisitions have been seen as a means of acquiring technology and expertise faster than would be possible through internal R&D.
- **The currency hedge**
  Gaining exposure to dollar-based revenues and profits, even when expensively purchased with cheap euros, has been considered an expedient hedge against the dollar's enduring strength.
- **Alternative financing**
  Cross-listing European shares in US equity markets has facilitated transatlantic transactions by providing companies with the necessary 'currency' to make deals affordable. So has the creation of the euro-denominated bond market.
- **Cross-border equity analysis**
  Emergence of a truly international equities market has led to an increase in global comparisons. Europeans believe judicious acquisitions can help them stand up to cross-border analysis.
- **Residual restrictions**
  While cross-border mergers in Europe have become more common, occasionally even those of a hostile nature, continental Europe remains a somewhat restricted market, where ostensibly fair deals can still be held up or denied outright. And this encourages large players to look elsewhere for acquisitions.

Success stories

Such drivers have produced a number of successful acquisitions from which three key themes emerge: one, the embrace of Anglo-Saxon business practices; two, the creation of a US subsidiary, often shaped from the initial US target company and run largely by Americans, that enjoys a substantial amount of autonomy in selecting targets and overseeing post-merger integration; and three, the realisation of solid near-term benefits.

Ahold

Dutch food retail giant Ahold has established an impressive track record in selecting and integrating US supermarkets and food service companies. The key to its integration success starts by buying superior companies and letting local managers exploit the advantages offered by being part of a global network.

US deals are executed by Ahold USA, the company's American subsidiary created in the mid-1980s from Ahold's original US acquisition. Target criteria are quite specific. A company must be the first or second player in the regional market, or have the potential to become No. 1, enjoy high customer appeal, have well qualified management willing to work for Ahold, be profitable and have the potential to increase profits, offer potential synergies; and emphasise food quality, nutrition, and safety in its marketing.

Patience is a compelling quality of Ahold's deal making. Since there are a limited number of companies that meet its selection requirements, the Dutch retailer may initially target a firm that is not even up for sale, willing to court a potential acquisition for an extended period to ensure a friendly, effective takeover.

AXA

In acquiring a 53 per cent controlling stake in Alliance Capital, one of the world's top-performing asset managers, Paris-based insurance giant AXA has helped transform itself into a global financial services company. A key to the 1991 acquisition, a by-product of its buyout of Equitable Life of the US, has been to allow Alliance to operate virtually independently from corporate headquarters. There has been no rebranding or cultural or administrative assimilation. In fact, Alliance is in direct competition with AXA Investment Managers, the European asset management arm, and recently beat it in a contest to manage the Italian pension fund Epta's €420m of assets.

The purpose of this head-on competition is threefold. One, Alliance keeps all fees, enabling it to sustain its attractive compensation packages and retain its talent. Two, challenging Alliance's autonomy could undercut its competitiveness and aggressiveness. And three, AXA wants to harness Alliance's success of selling mutual funds to middle America and apply it across Europe, improving AXA's overall performance while lighting a fire under the parent company's other asset managing arms.

Adecco

The global temporary staffing leader Adecco is itself the product of a Swiss-French merger, which observers argue gives it critical insights into the takeover process. Its 2000 acquisition of Olsten, the leading US temporary staffing service for $3bn, appears to have been a fairly seamless process. 'The bulk of the integration was executed in six months,' explains Goldman Sachs analyst Meg Saegebarth, 'and was an improvement over its fairly agile 1998 takeover of TAD, and vastly superior to Dutch staffing agency Ranstad's troubled takeover of US-based Strategix."

Speed of integration is especially critical where, as in this case, there is an initial net revenue loss resulting from the tendency of clients served by both firms to replace one after the merger to ensure access to a number of independent agencies.

Adecco was able to find compensating synergy savings by shifting its US headquarters from California to Olsten's Long Island facilities because of the latter's superior IT systems.

As it does in all deals, Adecco made a point of quickly targeting all critical

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regional leaders, spelling out its intentions and telling them they will remain a key part of management. And to assuage middle- and lower-level staff uncertainty, the company promised to maintain all branch offices for at least one year after the takeover. This let workers know that they would be given the opportunity to prove their worth to the company.

Past unseen

For every success story there are two or three troubled transatlantic marriages, though managers keen to learn the lessons will find these cases analysed less extensively. Studies prepared by consultants, academics, and analysts show a lack of detail and candour, while companies are often reluctant to disclose much about the post-merger integration process. Perhaps that shouldn't be much of a surprise. As Booz Allen's Adolph puts it, 'going public with your knowledge is like giving away your play book."

The degree of discretion sometimes seems to go beyond proprietary information. More than three years ago, as it prepared to merge with Chrysler, Daimler prepared an extensive survey of 50 failed cross-border deals. Even now, however, the company refuses to share its findings, perhaps fearing the data could be used as a gauge for measuring its own shortcomings.

Unfortunately, corporate confidentiality also limits the credibility of academic studies.

One of the more detailed ones, 'Cross-Border Acquisitions of US Technology Assets,' published in the *California Management Review* in Spring 2000, focused on six takeovers involving EU acquisitions of 'Silicon-Valley-type' companies. The authors, Andrew C. Inkpen, Anant K. Sundaram, and Kristin Rockwood, also interviewed a number of entrepreneurs, consultants, analysts, and journalists.

While the report delved into some of the issues of post-merger integration more effectively than most other available studies, the anonymity of sources reduces the impact of the analysis.

Technology lessons

These limitations notwithstanding, 'Cross-Border Acquisitions of US Technology Assets' provides insights into the managerial experiences of European takeovers of US high-tech firms.

The authors were motivated to examine the scale of European takeovers and the

Table 1: European takeovers of US firms Source: Thompson Financial Securities

% of Total US dollar Market Value of European acquistions in the US

	1994	1995	1996	1997	1998	1999	2000	2001 up to July 26	1994-2001
United Kingdom	40.7	22.7	43.1	31.5	53	55.7	32.1	17.2	
Switzerland	32.3	11.8	1.7	13.9	1.2	3.9	7.2	28.9	
France	16.3	12.2	4.8	16.9	6.7	17	11.8	20.5	
Sweden	2.4	3.8	4.7	6.2	3.6	0.6	0.9	3.2	
Germany	2.3	32.4	23.6	10.9	28.9	5.8	18.5	5.8	
Netherlands	2.1	8.2	18.3	14.2	4.5	12.5	15.9	8.6	
% of all European deals	**96.1%**	**91.1%**	**96.2%**	**93.6%**	**97.9%**	**95.5%**	**86.4%**	**84.2%**	
Total no. of European takeovers of US firms	281	347	380	436	548	715	884	324	3915
Total no. of Foreign takeovers of US firms	797	813	915	1066	1162	1373	1740	730	8596
Total no. of US takeover of European firms	615	747	854	1002	1167	1059	1010	414	6868
No. of European vs all foreign takeovers of US firms	**35.26%**	**42.68%**	**41.53%**	**40.90%**	**47.16%**	**52.08%**	**50.80%**	**44.38%**	**45.54%**
Ratio of the no. of US takeovers of European firms vs European takeovers of US firms	2.19	2.15	2.25	2.30	2.13	1.48	1.14	1.28	**1.75**

troubles that ensued. Out of the $250bn in non-US acquisitions of American technology companies during the 1990s, 60 per cent were done by firms from the European Union and three-quarters of these occurred between January 1998 and July 1999. And many of these European buyers have struggled with both the integration and governance of acquired firms. Based on accounting and stock market performance measures, the acquisitions have not, on average, created value for acquiring firms.

The study found that European companies sought significantly larger deals than most other foreign shoppers, and paid on average three times the premium typically shelled out by US acquirers due in part to their inability to hide their intentions from the financial markets. Further, European companies are more likely to use cash than stock to acquire a firm, which can make the deal inherently more risky.

Europeans have also had problems with issues of employee control and compensation. Startups in Silicon Valley, frequent European targets, have flourished under a very flexible work environment. European companies often restrict this freedom and are not accustomed to granting large amounts of stock to key employees or spinning off valuable operations as means of compensating high-powered teams.

Post-merger integration

While there was no consistency about the way Europeans integrated US assets, the authors observed several common problems. The European decision-making process was slower than the Silicon Valley norm. In a number of instances, the study revealed excessive European dependence on data and information, and heavy reliance on achieving consensus. As a result, there was a general lack of personal accountability, with 'nobody willing to be the decision maker." Target companies found this approach costly, putting market opportunities at risk.

Acquired management also found Europeans reluctant to embrace two fundamental characteristics of high-tech culture: risk and change. US start-ups are anxious to get a product to market; remedying bugs can occur at a later stage when fine-tuning for market response. European management, on the other hand, is more focused on first studying demand, developing marketing plans, and perfecting a product before releasing it – assuming it's possible to get all things right first time around.

European acquirers did a poor job communicating their vision for the acquired organisation. Because target firms sometimes sensed a lack of clarity as to their roles in the enlarged firms, employee departures became a significant problem in a number of instances.

Communication method was also an issue. European companies prefer personal contact, followed by telephone, fax, and e-mail; Silicon Valley relies heavily on e-mail.

Table 2: European acquisitions in US by sector Source: Thomson Financial Securities

	1994	1995	1996	1997	1998	1999	2000	2001 up to July 26	1994-2001
% of Total US dollar Market Value of all acquisitions in the US market									
Telecommunications	11.4	0	0	0	3.3	27.3	14.7	12	
Oil and gas; petroleum refining	0.9	0	0.6	1.3	28.9	15.2	1.1	0.1	
Business services	5	1.9	3.5	6.9	2.4	8.1	9.9	9.4	
Investment & commodity firms, dealers, exchanges	2.4	4	4.9	8.1	1.6	1.7	15.3	6.2	
Insurance	0.4	7.6	13.8	8.3	2.4	6.4	8.5	1.9	
% of total market value	**20.1**	**13.5**	**22.8**	**24.6**	**38.6**	**58.7**	**49.5**	**29.6**	
Number of deals									
Telecommunications	5	3	4	4	12	19	13	10	70
Oil and gas; Petroleum refining	10	5	7	15	11	13	15	4	80
Business services	27	41	39	58	66	120	234	72	657
Investment & commodity firms, dealers, exchanges	13	12	21	17	23	30	39	16	171
Insurance	10	5	6	16	12	16	11	2	78
Total number of deals	**281**	**347**	**380**	**436**	**548**	**715**	**884**	**324**	**3915**

Perhaps because they are new to Silicon Valley, Europeans have yet to embrace the region's informal social networks that make it easier for companies to help each other in new markets and avoid duplication of effort through joint ventures, special licensing agreements, and common technical standards. Further, Europeans tend to socialise with each other to the exclusion of target firm employees.

The study also found managerial continuity lacking. Acquiring managers appeared and then disappeared. In one exceptional case, an insider reported that the target CEO "is not even coming to work every day because he gets no direction from the acquirer and is extremely demotivated".

Compensation and governance have also been issues. Across most of non-Anglo-Saxon Europe, management and employee salaries are almost entirely based on a fixed salary plus bonus, something unthinkable in US tech firms where options are an essential form of reward. 'One share, one vote' underpins shareholder rights in the US, but is far from what is practised in continental Europe where different classes of shares enjoy different voting privileges, where limits are sometimes placed on the influence of very large shareholders, and where government-owned minority holdings often retain the right to kill off deals.

Banks are one of the most influential stakeholders within continental European firms. They play an active role in the governance process and have major board representation, something largely uncommon in US. The *modus operandi* in Silicon Valley invariably collides with banking interests. Focusing on predictability of cash flow and traditional valuation yardsticks, bankers would tend to view a Silicon Valley firm with no bricks and mortar, negative cash flow, and high labour turnover as high risk.

So it is then ironic to see a number of European banks struggle miserably with their transatlantic ventures. 'More often than not,' a recent *BusinessWeek* survey reported, 'European institutions have made ill-considered acquisitions or mismanaged the ones that did make sense." After getting socked by a plunging stock market and the collapse of nearly all things internet, Deutsche Bank recently sold New Jersey-based National Discount Brokers to Ameritrade for \$154m, or nearly 40 per cent less than what it paid for it just a year before. Zurich Financial Services' acquisition and merger of no-load Scudder funds and Kemper load funds hasn't worked out well. And Dresdner Bank's high-priced acquisition of Wasserstein Perella has been less than successful.

A new trend

According to Booz Allen's Adolph, many European takeovers have been strategic in nature, offering a new piece to the corporate mosaic focused on achieving long-term benefits. While that sounds prudent and offers substantial upside, Adolph explains the problem of such excursions into previously uncharted territory is that companies are going into sometimes ill-defined new markets, without significant US experience, where language and cultural gaps are likely to be wide, and synergies limited due to the lack of any existing operations. Accordingly, such strategic investments come with much greater risks than straightforward consolidation of existing minority positions.

Deals that immediately exploit overlapping operations and expand market access have the opportunity to realise substantial cost savings and improve profitability within 18 months of the acquisition. Achieving these gains is not only critical for the internal well-being of a company, but is essential for demonstrating to analysts and investors that the current corporate strategy is working. And generating this momentum is crucial for achieving long-term gains.

Looking at DaimlerChrysler demonstrates how severely the market will punish cross-border deals that, while possessing a long-term logic, fail to sidestep integration pitfalls and generate near-term gains. At the same time, DaimlerChrysler broke a cardinal rule: while most deals are invariably acquisitions, deals between equals must be mergers.

Perhaps in response to past troubled deal making, Adolph sees a trend in European takeovers, one that's increasingly embracing an Anglo-Saxon focus on quickly effecting intensive organisational review and that's not fearful of temporarily disturbing existing operations in the process. Instead of patiently moving toward long-term goals at the expense of current financial performance, a new generation of CEOs like Vivendi Universal's Jean-Marie Messier, Suez's Gérard Mestrallet, and TerraLycos' Joaquim Agut are simultaneously focusing on achieving near-term benefits to justify and propel their deals. And what this strategic shift is ultimately reflecting, according to Booz Allen senior vice president Bruce A. Pasternack 'is that companies are paying as much formal attention to post-deal integration as they pay to the pre-deal part of mergers." PwC's Denis Picard agrees: "the challenge for making deals successful is increasing as the US economic slump is taking its toll on operating results, and in particular in the manufacturing and technology sectors".

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