New challenges and integration models in cross-border M&A

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Abstract

The emerging of some SudAmerican, Asian and East European countries with billions new workers and consumers are changing global competitive system. The diffusion of global economic power across a wide range of regions and countries are creating new opportunities and risks that firms all around the world can't ignore.

New global scenario is affecting cross-border M&A in several ways. Cultural problems and main element of integration process are becoming more and more important for cross-border M&A success.

At the aim to investigate factors affecting cross-border M&A's success, we analyzed existing literature and explored current trend in cross-border M&A. Then we used case studies in automotive industry to evidences main factors affecting cross-border M&A's success.

Key words: Cross-borders M&A, cultural problems, integration model

Introduction

Over the last decades economic power has shifted from dominance of few economies to a greater dispersal of global economies. Multinational companies from both developed and emerging countries have expanded in size and geographical reach in a search for new markets, scale efficiencies, and competitive sources of capital and labor. The most important growth driver of multinational corporations has been cross-border mergers and acquisitions (M&A). However the high rate of failures relating to these operations evidences the difficulties entailed in successful integration process (Haspeslagh and Jemison, 1991; Pablo, 1994). Although cultural differences in current cross-border M&A are higher compared to the past waves, integration success depends mainly on the way in which these differences are managed. The main playground of integration mechanisms is defined within areas of leadership, communication, co-ordination and human resource. However, the majority of existing studies have analyzed only one factor among them. As a result, findings have been mixed and sometimes even contradictory. Few studies have tried to integrate various aspects to reach a better understanding of M&A success (Larsson and Finkelstein, 1999; Very and Schweiger, 2001). At the aim to investigate factors affecting cross-border M&A's success we analyzed some cases in automotive industry.

New challenges in the global scenario

The world is moving from an era of geographically concentrated economic power to one characterized by multiple centers of economic and business activity. Economic power has shifted from dominance of the triad economies United States, Europe and Japan to a greater dispersal of global economic power as developing economies contribute an ever-increasing share of the world's output, trade and investment.

The rise of multi-polar world is driven by the increasing power of information and communications technologies, government policies aimed to increase economic openness and geographic reach of multinational. Faster communications have allowed business functions to be disaggregated geographically and have also brought a vast array of service activities within the scope of international trade for the first time. Trade liberalization under the auspices of the World Trade Organization and the accession of some key emerging economies has increased levels of economic interdependence. A search for new markets, economies of scale, and new sources of capital and labor has vastly increased the geographic presence of multinational companies in emerging markets. Over the last three decades, multinational companies have expanded in size and geographical reach in a search for new markets, scale efficiencies, and competitive sources of capital and labor.

According to World Investment Report (2011), about 65,000 multinationals employed 54 million employees worldwide in 850,000 subsidiary and affiliate companies. The most important growth driver of multinational corporations is cross-border mergers and acquisitions (M&A). However the high rate of failures relating to them evidences the difficulties entailed in successful cultural integration. The biggest challenge of current cross-border M&A wave is cultural integration of firms that come from countries with different level of development (Schweiger and Goulet, 2000). Studies assert that up to 85% of cross-border M&A do not yield the success hoped for due to cultural barriers (Buono and Bowditch, 1989; Sudersanam, 1995). High cultural differences are sources of risk (David and Singh, 1994) and potential obstacles to realize integration benefits (Aguilera and Dencker, 2004). They can destroy potential synergies and shareholder value (Vermeulen and Barkema, 2001; Datta and Puia, 1995). Embeddings of firms undergoing acquisitions in highly different national

contexts has increased the relevance of factors such as cultural fit (Weber et al., 1996), management style similarity (Datta, 1991; Larsson and Finkelstein, 1999), cultural change (Kavanagh and Ashkanasy, 2004), cultural convergence (Birkinshaw et al., 2000), acculturation (Larsson and Lubatkin, 2001; Nahavandi and Malekzadeh, 1988), double-layered acculturation process (Barkema et al., 1996), acculturative stress (Very et al., 1996) to M&A success.

Against such a critical elements integration mechanism able to incorporate the acceptance of cultural diversity and to develop a common organizational-culture is a key phase for cross-border M&A's success (Mace and Montgomery, 1962; Kitching, 1967; Howell, 1970; Lindgren, 1982b; Jemison and Sitkin, 1986; Haspeslagh and Jemison, 1991; Birkinshaw et al., 2000; Child et al., 2001; Ranft and Lord, 2002; Nahavandi and Malekzadeh, 1988; Buono and Bowditch, 1989; Cartwright and Cooper, 1992; Véry et al., 1996, Weber, 1996; Weber et al., 1996; Véry et al., 1997; Morosini, 1998; Child et al., 2001, Vaara, 2002; Vaara et al., 2003; Marks, 1982; Bastien, 1987; Burke, 1987; Schweiger and Weber, 1987; Buono and Bowditch, 1989; Napier, 1989; Cartwright and Cooper, 1990; Schweiger and Denisi, 1991; Marks and Mirvis, 1997a,b).

Integration model

Although cultural differences in current cross-border M&A are higher compared to the past waves (Shimizu et al., 2004; Weber et al., 1996), cross-border M&A's success depends mainly on the way in which these differences are managed. Cultural clashes, in fact, don't depend on cultural diversities but on the way in which these differences are perceived and managed. For avoiding cultural clashes it is important to recognize cultural distance and manage the integration process appropriately. Gap-analysis of differences is the starting point of the integration process. In cross-border

M&A between firms with high cultural differences, potential conflicts due to individual resistance against cultural adaptation or integration can be managed through integration mechanisms. These mechanisms influencing cultural patterns of cognitions and behavior lead to the cultural balance between differentiation and integration (Dorow and Blazejewski, 2003). By changing the rules that define individual scope of action, integration mechanisms can change behavioral routines that in turn can induce a long-term adaptation of cognitive schemes through processes of internalization that serve to remove the internal dissonances between action, values and attitudes.

The main playground of integration mechanisms is defined within areas of leadership, communication, co-ordination and human resource policies (Morosini, 2003). A number of studies have found that forming key managers in new company requires mutual trust and integrity. Common languages have been found to be highly effective in facilitating learning and knowledge transfer between groups, when they are explicit, communicated and shared by the members of those groups. Coordination processes have been associated with substantial performance improvements within organizations. Finally in the integration process management have to consider that business is at the end a human activity. Culture, in fact, is embedded in people and is expressed through routines and capabilities. Thus, integration of different cultures call for an active participation of people at all levels. Identification of key employees and putting in place a balanced employee retention strategy and performance measurement plan can go a long way in ensuring continuity of business as usual and realizing people synergies. Recognizing and retaining valuable human resources is the only way to facilitate the success of current cross-border M&A.

At the aim to investigate main elements that affect cross-border M&A's success, we analyzed some cases in automotive industry.

Research Methodology

Although research on cross-border M&A has received increased attention in recent years, very little research has been carried out on main problem of current cross-border M&A wave. Considering the exploratory nature of our research objectives, we chose a case study research design. Case studies are especially appropriate when one is answering the questions why or how (Yin, 1994). This research design is based on Mill's theory of difference and allows the formulation of theories for success and failures (Eisenhardt, 1989). As suggested by Yin, we advanced our research question and identified potentially important constructs in the literature before collecting data. To get an initial understanding of the cases, we conducted web-based database research (Google Scholar, NACSIS, ProQuest, Wiso-net, etc.). In addition to web-based database research, we verified our findings with several external consultants and scholars to refine our discussion.

Case studies

Historically, the automotive industry was dominated by developed economies. But in the last decade, emerging economies have strengthened their role as production sites. In 2010, around 57% of the world's vehicles were produced in emerging economies. Asia accounted for the largest share of global disclosed deal value in 2010. Additionally, these large transactions also resulted in Asia receiving the largest net investment inflow as opposed to the past few years during which the region witnessed a net investment outflow. These large deals notwithstanding, nearly 80 percent of deal activity and 67% of disclosed value in Asia was transacted by regional buyers. The global economic downturn has done little to halt the momentum of overseas

investment by China. Many Chinese companies see M&A as a key component in transforming themselves into global organizations. Secondary markets such as Southeast Asia are viewed as a target market for their products with M&A as a viable entry strategy. These buyers are more likely to look west for M&A to acquire technology than to acquire production assets and market access. Key technologies in the areas of propulsion, safety, advanced electronics, and materials, are some areas that offer readily transferrable benefits to Chinese and Indian companies. Competitive labor costs and improved logistics infrastructure have prompted global automotive brands to shift their production focus to emerging economies. Meanwhile, thanks to rising household income and trade liberalization, more people in emerging economies are buying automobiles. Today, this potent combination of competitive production networks and buoyant emerging-market demand is driving emerging-market integration and collaboration in the automotive sector. Thus automotive industry offers several cases of cross-border M&A through with to evidence relevance of main elements of integration process that can affect the operation's success.

At the aim to evidence the relevance of leadership, building blocks, communication mechanisms, co-ordination mechanisms and human resource policies in cross-border we identified many cases of cross border M&A success.

Daimler -Chrysler

Daimler Benz and Chrysler announced their merger in May 1998, when the former was the world's top brand in luxury cars and the latter was the world's most profitable carmaker. After one year of high value, from 1999 to 2001 Daimler-Chrysler's shareholder-value experienced a steady decline of over 40%. The reasons behind these dismal performance results can be traced back to the period of post merger integration. After achieving their early post merger integration results, both merging

companies were to be managed as separate entities in order to maintain the integrity of their brands and their distinct pre-merger corporate cultures. Therefore, the new company was not able to implement an integration process, no common organizational blueprint, no major know-how exchanges, no single set of global personnel policies and no unified building blocks. In the absence of an integration process Daimler-Chrysler's attempts to gain competitive advantages by combining both merging companies' strengths, were lost along the cultural, functional and organizational divides in place. Interestingly, as a result Daimler-Chrysler ostensibly shifted to one cultural environment with some of former Chrysler's key managerial talent leaving the company during 1999 and 2001. This made the sharing of knowledge and the building of a common pool of corporate values even more difficult. The failure of post merger integration process lead to the separation of two entities in 2009.

General Motors-Fiat

Fiat was for many years one of the leading automotive companies in Europe. In the early nineties Fiat's market share reached 50% in Italy and 14% in the rest of Europe. The success of Fiat allowed the owners, the Agnelli family, to create a diversified holding, the Fiat Group, with interests in the manufacturing of trucks, railroad equipment, aircrafts, automotive components, machinery, as well as financial and insurance services. The Agnelli family was amongst the wealthiest of Europe.

But in 2003 Fiat was practically bankrupt. The company had been losing huge amounts of money but the key problems had not been addressed. The Fiat Holding, sometimes through divesting from some of its companies, provided funding to cover Fiat loses through either capital increases or debt. After several management changes

Sergio Marchionne was appointed CEO of the company and he applied speed to the ideas which has been presented by previous top managers.

General Motors had shown a strong interest in Fiat in 2001 and acquired 10 per cent of the company and established also a purchasing alliance for common components. The details of the deal had not been widely known until Mr. Marchionne took over the management. General Motors had signed a clause that would allow Fiat to request the acquisition of all the shares held by the Fiat Industrial Holding at market value (Fiat Automotive was listed) but also would have to return the debt, continue to purchase components from Fiat Group suppliers and consult with Fiat before any strategic decision.

When Marchionne got power he immediately requested General Motors to proceed with the acquisition. This was in 2004 and General Motors did not foresee a brilliant future for itself and saw it difficult to justify a move like that to its shareholders.

Considering cultural differences and not identifying the possibility to develop an mechanism able to achieve an integration through leadership, communication, co-ordination and human resource policies. General Motors rejected the deal. Thus Marchionne brought them to curt and finally General Motors agreed to pay close to 1.5 billion dollars to avoid the acquisition. This money was helpful in the turnaround of Fiat that Marchionne successfully implemented. In spite of this crisis, the two companies continued to work together in the purchasing alliance that brought positive results when they coordinated the use of common components in their new car designs. Sergio Marchionne put emphasis on the speed in the implementation of tough restructuring processes. Trying to optimize every decision when the company is losing money and market share every minute does not make much sense. Fast sub optimization looking for value creation should be the priority.

Following this fast turnaround with tough adjustments, Marchionne went into an intensive leadership effort to bring enthusiasm back to a company that had gone through years of decline. The company recovered market share, prestige and value in a significant way.

Geely-Volvo

In 2010 Chinese automaker Geely's acquired the Swedish brand Volvo from Ford. Through this M&A Geely's chairman aimed to take advantage from Volvo's quality and high technology to improve product line-up and its brand differentiation in China. While there is hardly any competing nature within the product lines of Volvo and Geely, as such, sufficient care must be undertaken on the fronts of aligning a clear strategy, enhancing efficient cross-cultural integration and human resource management between Volvo and Geely. With the Volvo base remaining in Sweden, it will help preserve its European heritage as well as its loyal customer base. However, the knowledge and know-how will eventually move to the East and into its own product line-up. It is of fundamental importance to have proper platform and portfolio alignment that are eventually lined-up for the medium-term. With Volvo's 10 different product line-ups, Geely's total product line-up now is 18, with 15 more product platforms planned in the near future. For Geely, Volvo could bring in a lot more challenges than advantages considering some of the failed deals within the history of the automotive industry. Daimler-Benz's deal with Chrysler was suspended due to a multitude of factors ranging from misalignment with respect to product lines, conflict of interests among decision-makers, and others. Geely has to avoid the same mistakes of its predecessors. It is also an opportunity for Geely to build its brand name and experience on managing both mass-market and luxury vehicles in its portfolio. The deal is expected to help Geely leap-frog in technology when much of its Chinese

counterparts have government support that give them access to technology and finance. With a well-established supply chain of Volvo, together with the existing talent in the research and development team, Geely has ensured that it will stay well-ahead of its domestic competitors.

Conclusions and discussion

Under pressures of current multi-polar world many cross-border M&A failures are due to cultural challenges. Our article focuses on automotive industry because it is a good example of an industry in which emerging economies have strengthened their role as production sites Chinese prosperity has attracted foreign investors. The global economic downturn has done little to halt the momentum of overseas investment by China. European and American companies have required rationalizations and alliances. Many Chinese companies see M&A as a key component in transforming themselves into global organizations. Specifically, this study focuses on acquisitions between companies from very diverse cultural backgrounds. On the one hand, cultural differences offer great chances to learn from each other and may result in superior performance (Morosoni et al., 1998). On the other hand, such acquisitions and alliances are more difficult to manage successfully and have a high potential for failure. Our case-study research design, and selection of some cases with similar starting points, but different outcomes, allows us to sharpen our understanding of the effects of leadership, building blocks, communication mechanisms, co-ordination mechanisms and human resource policies as relevant factors in the integration process of acquisitions or alliances between American, European and Chinese firms.

While business and human relations might be separate in a Western context, in Asian context these concepts seem to be strongly interwoven. Moreover, in collective societies, outsiders might face hostility or simply be ignored. In this regard, the

contribution of this research is two-fold. First, we provide an integrated model of integration management of cross-border acquisitions between European and Chinese firms. Second, we explore various factors accounting for success of cross-border acquisitions.

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