**ROLAND BERGER** STRATEGY CONSULTANTS

think:act CONTENT

Fresh thinking for decision makers

# New opportunities for strategic acquisitions

## European companies have developed an excellent feel for how to select, acquire and integrate other firms | But what are the factors that drive successful M&As?

OCTOBER 2007

# $1,590,000,000,000

*In 2006, mergers and acquisitions in Europe reached a total value of USD 1.59 trillion – more than the volume of transactions in the USA.*

*Source: Dealogic*

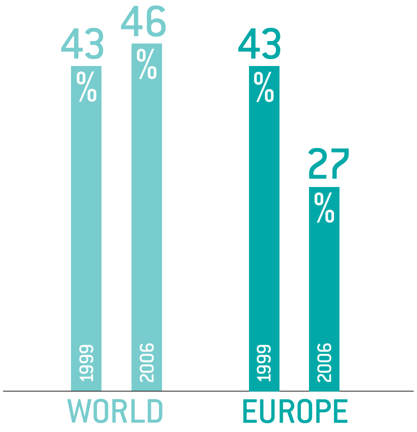
## MERGERS & ACQUISITIONS: EUROPE GAINS GROUND

Following the US financial crisis, the once overheated M&A market is cooling off. The good news? Acquisition premiums are falling and are creating new opportunities for strategic investors. Mergers and acquisitions are making a successful comeback and have become a key element of corporate growth strategies. And in recent years, European companies have emerged as increasingly strong players in the global M&A market. There are many reasons for this development. While Europe is currently experiencing a robust economic growth phase, its figures are nowhere near the rate of expansion in the world's boom regions. Organic growth alone can thus not meet investors' expectations. In addition, many companies responded to the 2000/2001 economic crisis by cutting costs, refocusing on their core activities and cleaning up their balance sheets. The successful implementation of these measures has now left them with assets to spare – and in many cases made them strong enough to enter the M&A arena as true global players. Their renewed strength also allows them to deliver expected returns and successfully defend themselves against takeover bids.

European companies have developed an excellent feel for how to select, acquire and integrate other firms. This is undoubtedly linked – at least in part – to the challenges they have long faced, situated as they are in such a fragmented geographic and cultural context. They have become singularly adept at buying and merging with the "right" companies. In 2006, the volume of M&A transactions actually overtook that of the USA. Merger and acquisition deals worth a total of USD 1.59 trillion were closed in Europe, against USD 1.54 trillion on the other side of the Atlantic. Within the framework of our pan-European "Best of European Business" (BEB) competition, we closely examined the performance of 8,000 European companies. We analyzed five factors that are instrumental to the success of leading European M&A players. They have learned to turn their own domestic market into a strategic advantage in the context of cross-border, intra-European mergers. The findings of the BEB competition correlate closely with Roland Berger's experience over the past four decades, during which we supported countless companies through the acquisition and integration phases.

## EUROPEANS PAY LESS

*While acquisition premiums break record after record elsewhere in the world, European companies are paying less and less.*



*Source: Thomson Financial*

## SUCCESS FACTOR 1: CLOSE CONTACT

As European integration progresses, many companies are realizing that an enlarged EU marketplace translates into a wider domestic market for their products and services. Open European borders are also an asset when it comes to M&A transactions. Why? Because a key characteristic of a successful merger is that both sides have in-depth knowledge of each other's inner workings. All BEB winners, for example, had a clear picture of their acquisition target's business models. Many of them already had close personal ties to the top executives of these firms. They knew their internal workings, procedures and processes, which enabled them to realistically assess both the benefits and the potential difficulties of integration far in advance of putting an offer on the table.

Advanced networking across an open market has other advantages. It enables the buyer to define the future business model even ahead of launching a bid. Thus, the buyer can make a more compelling case and approach deals from a position of strength. Ahead of their respective mergers, all BEB M&A award winners had already formulated business models for immediate post-merger implementation. They were thus able to avoid the pitfalls that so often plague corporate marriages trumpeted as "mergers of equals", but that ultimately dilute both the core brands and/or business models of the two partners.

*Cement producer **Holcim** started out as the junior partner in a merger with India's Ambuja, which it has since successfully integrated. The companies' joint activities grew out of a trust-based relationship between the two owners, and out of closely intertwined processes and a string of personal contacts. Britain's **Ineos** also knew its acquisition target inside out: Innovene, a BP spin-off, had been a good customer for many years. **Unicredit**, too, winner of the Italian BEB competition, adopted an exemplary approach. The bank developed a business model in which customer satisfaction figured as one of its key performance indicators. In addition, Unicredit applies a "mass-produced" business model that strictly separates its sales activities from its back-office operations. A tight network of branch offices thus keeps the bank close to its customers, while all other services are handled by a single, large, centralized division. In targeting Germany's HypoVereinsbank, the Italian giant picked an acquisition candidate whose presence in Central and Eastern Europe fit perfectly with its own growth strategy.*

## SUCCESS FACTOR 2: PROFESSIONAL M&A MANAGEMENT

Europe's open borders have significantly intensified competition. The legal changes that have accompanied European integration along with the deregulation of numerous industries are putting an even tighter squeeze on companies. Cross-border mergers and acquisitions constitute an important response to this intensifying pressure. But top companies have evidently learned how to turn this pressure cooker situation into an advantage, creating distinctive business models that work. Aware of the business potential, they have ramped up their M&A capacity and have professionalized their approach to such deals. Many of them are experienced M&A players and strategically use their knowledge both in charting new deals and integrating new companies. The most successful have even created dedicated teams of in-house experts – in some cases even whole departments – whose sole job is to prepare acquisitions and the post-merger integration. Their job includes mapping out a strategy that will unite the best of both corporate worlds in a way that exploits the local strengths of both partners. In many cases, previous, smaller acquisitions or collaborative ventures have given these companies the valuable experience they need to pave the way toward larger follow-up deals. The reward for such a systematic approach is a higher stock price, as investors assume that the experience of these "serial acquirers" will work in their favor.

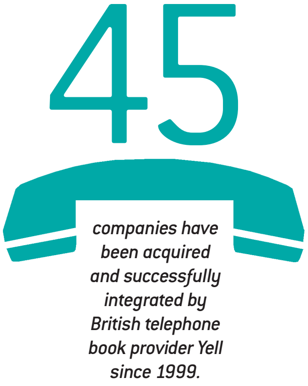
*Since 1999, British telephone book provider **Yell** has purchased and integrated no fewer than 45 companies. Investors see the sheer volume of its completed integration projects as evidence of the group's strategic competency. Acquiring other firms is also part of the corporate DNA of petrochemicals manufacturer **Ineos**. A company that started out as a management buyout has thus gradually emerged from the shadows of the market leaders*

BEB
BEST OF EUROPEAN BUSINESS

### AND THE WINNERS ARE:

*Winners of the "Best of European Business" competition in the category "Cross-Border Mergers and Acquisitions"*

*ABN Amro, Netherlands*
*Campari, Italy*
*Dassault Systèmes, France*
*EDP, Portugal*
*E.ON, Germany*
*Fertiberia, Spain*
*Holcim, Switzerland*
*Ineos, UK*
*Lottomatica, Italy*
*Pernod Ricard, France*
*PKN Orlen, Poland*
*Telefónica, Spain*
*Ten Cate, Netherlands*
*Unicredit, Italy*
*Yell, UK*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*companies have been acquired and successfully integrated by British telephone book provider Yell since 1999.*

# [NEW OPPORTUNITIES FOR STRATEGIC INVESTORS]

*As acquisition premiums drop, new opportunities are arising for strategic investors in many industries*

*The table below outlines the opportunities that exist in key industries*

*The maps reflect expert assessments: M&A activity will remain high and its center of gravity will shift toward Western Europe*

■ *Current*
↗ *Trend*

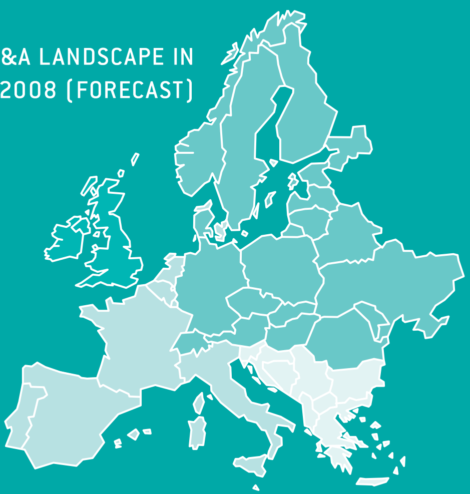
| INDUSTRIES | DEGREE OF CONSOLIDATION | M&A ACTIVITIES | THINGS TO KNOW |
|---|---|---|---|
| | *Low* \| *Moderate* \| *High* \| *Very high* | *Low* \| *Moderate* \| *High* \| *Very high* | |
| Industry and chemicals | Moderate ↗ | High ↗ | *Fierce competition from Asia and the Middle East*<br>*Increase in the activities of private equity (PE) firms* |
| Consumer goods and retail | High → | High → | *Retail already heavily consolidated*<br>*Further consolidation expected in some segments of the consumer goods industry (beer, dairy products, etc.)* |
| Telecom and media | Moderate ↑ | High → | *Telecom market already heavily concentrated*<br>*Extensive PE involvement in telecom sector*<br>*Media very attractive to PE* |
| Financial services | Moderate ↗ | High → | *Largely national markets*<br>*Consolidation varies greatly from country to country*<br>*Role of cross-border M&As increasing* |
| Energy and utilities | Moderate → | Moderate ↘ | *Small firms need to find partners*<br>*Trend toward extensive vertical integration* |
| Leisure | High ↗ | Moderate ↗ | *Following the first wave of consolidation in the 1990s, Thomas Cook/MyTravel and TUI/First Choice have unleashed a second wave. Online portals are forcing a strategic rethink* |
| Transportation | Moderate ↗ | Moderate ↗ | *Deregulation of the rail travel and civil aviation markets will trigger further consolidation and more M&As. Logistics firms will increasingly become acquisition targets* |
| Pharmaceuticals and medical systems/biotech | Moderate ↑ | Moderate ↗ | *Consolidation primarily among SMEs, especially those that focus on generic drugs and research*<br>*Slight increase in M&As (5%) in 2005* |
| Construction | Moderate → | Moderate ↗ | *Structural differences between individual European markets*<br>*SMEs predominate in Germany and Italy, large groups in France and Spain* |

## EUROPEAN M&A LANDSCAPE IN 2006

Intensity of M&A activities

- 🟦 *Very high*
- 🟦 *High*
- 🟦 *Moderate*
- ⬜ *Low*

## EUROPEAN M&A LANDSCAPE IN 2008 (FORECAST)



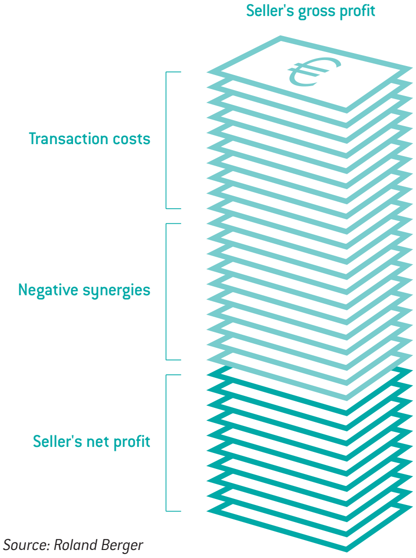
*Source: Dealogic*

*to become the world's third-largest supplier of petrochemical products. Today, the PMI skills of its management team rank as Ineos' principal success factor.*

Professional management of these processes also affects an area that is regularly underestimated in the context of mergers and acquisitions. Around a quarter of the M&A activities we studied involved the spin-off of a subsidiary or an entire division. In some cases the parent company chooses this *modus operandi* to liquidate assets, in others to sharpen the group's strategic focus. Either way, these types of demergers must satisfy the same criteria as full-fledged takeovers: They must serve to increase the long-term value of the company. Compared to acquisitions, however, managers generally pay far less attention to these kinds of demergers, and this negligence can spell trouble: Revenue losses are not examined in light of overall strategy. In other cases, key business processes and systems have not been properly disengaged by the time the transaction goes through. Despite the significant impact of such deals, the sale of these corporate units is often not handled by a team of specialists. Instead, general administrative staff are simply expected to manage all the problems alongside their regular duties.

## HEAVY LOSSES

*Spinning off divisions or corporate units needs careful planning. Otherwise, the entire proceeds of a sale can be squandered. The true transaction costs and negative synergies are often underestimated or recognized only when it is too late.*



*Source: Roland Berger*

## SUCCESS FACTOR 3: CULTURAL KNOWLEDGE

Every cross-border merger or collaborative venture between two companies can potentially trigger a clash of corporate cultures, languages and management styles. In the past, American firms have been able to restrict themselves largely to their own cultural sphere – due in part to the sheer size of the North American market. European companies have learned to actively address cultural differences even before putting their feelers out to neighboring markets, where they plan to build production locations or sales organizations.

The first change is generally the choice of a *lingua franca*. Here, continental European firms often opt for English, which is frequently a foreign language for both the buyer and the acquired company, creating a level playing field from the outset. However, choosing a common language is only one small aspect of a true cultural merger. Often, existing differences in management styles and corporate communication, for instance, don't manifest themselves until the day-to-day operations of the new company kick in. In an extensive survey, we compared the existing corporate cultures in Germany and France. The findings are clear: Different training and educational backgrounds, divergent management concepts, different social traditions and major differences in managerial structures and approaches to corporate governance, which further complicate any corporate merger.

Successful European M&A players attach great importance to "cultural fit" from the earliest days of their deliberations. Above all, this involves bringing the two sides together as equal partners, at least in spirit. Transparency is a crucial ingredient to closing preliminary talks successfully. Anticipated synergies, job guarantees and planned organizational changes must be discussed as openly as possible. The motives for and objectives of the merger must be explained convincingly to employees and the public at large. Also, to guard against a large-scale exodus of specialists and executives – and prevent damage to the company's image in the eyes of customers – employees on all levels of the target company must be actively involved in the decision-making process.

*__Royal Ten Cate__ is a perfect example of how important a good cultural fit can be to a successful merger. The takeover of Polyfelt, an Austrian manufacturer of synthetic geotextiles, proved to be more than a perfect match for the Dutch BEB winner's buy-and-build strategy. By intelligently involving the employees of both companies and carefully remodeling the reporting process, Ten Cate was also able to integrate its new acquisition quickly and seamlessly. Another example is Italy's __Lottomatica__, which worked hard to win the trust of employees at Gtech, its US acquisition target. The new company is now US-managed by its current CEO and former Gtech boss Bruce Turner.*

## SUCCESS FACTOR 4: KNOWLEDGE OF REGIONAL SALES MARKETS

Europe's diversity affects all aspects of doing business in the region, including its sales markets. Here European companies have had an advantage from day one, as they understand that the rules of the game can be very different in their neighboring country. Given both the European regulatory context and local health and safety provisions, it is not always possible to sell standard, unmodified products in other markets. Advertising and marketing, too, must accommodate the individual requirements and characteristics of other countries if their products are to be successful.

Thus, European leaders in this field have developed distinctive strategies for new target markets. They have successfully applied this principle not only in entering new markets in Europe, but also in their expansion to other continents. We found that European firms are increasingly willing to give greater decision-making powers to local employees of newly acquired companies. They trust their local knowledge and feel for the market, allowing the buyer to reap the benefits of the company's existing strengths in target markets.

*French spirits producer __Pernod Ricard__ could not have done a better job of acquiring Britain's Allied Domecq. The merger made Pernod the second-largest beverage company in the world. Unlike rival Diageo, however, Pernod remained strongly committed to a varied regional product strategy. A localized strategy of mixing Chivas Regal whiskey with green tea thus made Chivas the top export liquor of its kind to the Chinese market – far ahead of rival Johnnie Walker, for which marketing is strictly uniform around the globe. In all of its M&A activities, Pernod also systematically takes regional sales organizations on board and gives them considerable leeway to conduct their local operations.*

Understanding and addressing legal and regulatory issues successfully is also a key factor for companies in Europe. Unlike in the USA, varying standards and legal provisions in different countries often make it impossible to simply "cut and paste" existing production forms and business processes onto new acquisitions "as is". Even within the single European market, liability issues, taxation, labor law and warranty provisions still vary from country to country. The more extensive a company's advance knowledge of these factors, the better these can be taken into account during the integration process.

"WE ARE PREDATORS"

*Enzo Visone, CEO of Campari*

## SUCCESS FACTOR 5: POLITICAL REALISM

Cross-border mergers and acquisitions in Europe naturally have to satisfy the requirements of EU antitrust law. Yet they also frequently have to overcome fierce political resistance and latent protectionist tendencies. Leading EU member state politicians confront the EU Commission time and time again, arguing in favor of their "national interest" to protect domestic companies from takeover bids. Despite all legal efforts to the contrary at the European level, some countries still have what are known as "golden shares". These enable individual shareholders – usually the government – to extend their voting rights or curb those of other shareholders. European companies are keenly aware of these issues as well as the reemerging protectionist trend. In response, they have developed functional strategies that allow them to negotiate successfully both in Brussels and on an individual member state basis. They are smart enough to anticipate political resistance and work toward paving the way toward a smooth merger before they even submit a bid.

***ABN Amro** became one of the first foreign banks to gain a foothold on the lucrative Italian market by snapping up Antonveneta. The success of the Dutch bank can largely be attributed to a business model that focuses primarily on corporate customers. In light of prevailing EU law, even Antonio Fazio, head of Italy's central bank, had to abandon his attempt to prevent ABN Amro's "attack" on the Italian banking market. The jury for the BEB competition praised ABN Amro's ability to "safely navigate the choppy waters of the Italian market even in the face of stubborn resistance."*

Another important prerequisite is a company's ability to communicate its merger strategy openly and coherently. All BEB competition winners were able to explain the inherent logic to their M&As in the context of a compelling overall strategy, thereby minimizing the resistance of employees and shareholders alike.

*Here, cement maker **Holcim** sets another fine example. Its CEO, Markus Ackermann, communicated a dual strategy based on two clearly defined objectives: growth in emerging markets and vertical diversification in industrialized countries. The companies Holcim has acquired to date fit perfectly with this strategy. They include Aggregate Industries (a leading manufacturer of cement additives in the UK and the USA), Ambuja (the second largest cement producer in India) and Cemento de El Salvador (the biggest player in Latin America).*

## LEARNING FROM THE EUROPEAN CHAMPIONS

In recent years, European companies have gained a lot of ground in the global race to merge and acquire. The volume of M&A transactions has increased radically – and the quality of their execution has been markedly improved. Even as the recent financial crisis triggered in the USA poses new questions, new opportunities are opening up for strategic investors – especially in Europe.

Our analysis of the success factors for cross-border mergers and acquisitions found that European firms have learned to leverage their traditional strengths. Similarly, our practical experience in supporting such cross-border transactions indicates that European companies are well placed to make excellent use of their networking skills on a global scale. Globalization presents European players with a tremendous opportunity to continue exploiting their inherent strengths and thereby secure lasting growth in the future. Thus, European firms will remain one of the driving forces behind M&A activities in the years to come.

PLEASE CONTACT US IF YOU HAVE ANY QUESTIONS:

*Vincent Mercier*
*Managing Partner, France/Belgium*
*+33 (1) 53670-326*
*Vincent_Mercier@fr.rolandberger.com*

*David Stern*
*Managing Partner, United Kingdom*
*+44 (20) 7290-4865*
*David_Stern@uk.rolandberger.com*

*Dirk Hanßen*
*Partner, Corporate Performance*
*+49 (40) 37631-4306*
*Dirk_Hanssen@de.rolandberger.com*

think:act CONTENT
*Publishers: Burkhard Schwenker, António Bernardo*
*Overall responsibility: Torsten Oltmanns*
*Project management: Cathryn A. Clüver*

*Roland Berger Strategy Consultants*
*Am Sandtorkai 41*
*20457 Hamburg*
*+49(40) 37631-40*
*news@rolandberger.com*

Roland Berger
Strategy Consultants