



CROSS-BORDER ACQUISITIONS: BENEFITS AND DIFFICULTIES

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INTRODUCTION

The globalized business environment has encouraged companies to search for a competitive advantage that is also global in scale. Companies have been quick to respond to the needs of global customers and have started spreading their wings across continents. While deregulation, privatization, and corporate restructuring became a way of life in the 1990s, it resulted in an unprecedented surge in cross-border mergers and acquisitions (M&As).

Concept of Cross-Border Acquisitions

Cross-border acquisition (CBA) is the merger of companies that have headquarters in two different countries. Such acquisitions are treated differently from local acquisitions as they are governed by a different set of laws. They are also culturally very different. Some experts argue that mergers of companies with headquarters in the same country but branches across the world should also be treated as CBAs, as even these companies have to integrate operations that are spread across different countries. For example, when Boeing acquired McDonnell Douglas, the two American companies had to integrate their operations in dozens of countries across the world (Finkelstein 1999).

Need For Cross-Border Acquisitions

The increasing number of CBAs highlights their need and relevance. According to Securities Data Corporation, more than 2,000 CBAs, worth over \$252 billion, were announced in 1996. Compared to 1991, this represented a 54% increase in terms of numbers and three times increase in terms of amount (Finkelstein 1999). This Figure increased to around \$759 billion during 2000-09. This increase clearly indicates the increasing importance of CBAs in the global business landscape.

Every CBA involves two imperatives. First, every merger should create value. Value creation comes through synergy realization that cuts cost and facilitates competitive strategy repositioning to attain growth and increase revenues. Second, the synergy realization and competitive strategy' goals cannot be achieved without focusing attention on issues relating to acquisition integration (Finkelstein 1999).

BENEFITS OF CROSS-BORDER ACQUISITIONS

Cross-border acquisitions are beneficial to both the acquiring company and the target company.

Expansion of Markets

Cross-border acquisitions open new markets for companies. It becomes easier for companies to enter foreign markets and sell their products once the domestic markets are saturated. This helps companies

to diversify into markets that provide growth opportunities.

Possibility of Raising Funds Abroad

Cross-border acquisitions also enable the merging entities to tap foreign capital markets. This option ensures the availability of adequate financial resources at reasonable rates.

Synergistic Benefits

The acquiring company also derives synergistic benefits such as effective use of available resources, cost reduction, and reduction in labour force. Synergy increases revenue and thus profitability of the company.

Technology Transfer

Cross-border acquisitions facilitate the transfer of technology' from one country to another, which generates benefits for the acquiring entity. It results in the receiving unit assimilating or accumulating new knowledge, thus increasing its productivity. Transfer of technology affects the productivity of the acquired company at least in two ways: generation of new products and improvement of production technology (Ravenscraft and Scherer 1987).

Tax Planning and Benefits

Cross-border acquisitions also result in tax benefits as the acquirer can invest the profits in acquiring another entity, which generates tax benefits because capital investments are dealt with differently. In addition, if the acquiring company takes over the losses of the target company, the same can be adjusted against the profits of the acquirer. This reduces the overall income of the acquirer and helps the acquirer to take advantage of available tax benefits.

Foreign Exchange Earnings

Cross-border acquisitions open new vistas of earning for the company that enters the foreign market. These foreign exchange earnings come in handy for making further acquisitions and acquiring resources and technology for the existing units. This helps the company avoid raising fresh capital from the market or borrowing additional resources. Thus the company is able to maintain its existing capital structure and generate savings, as the cost of capital remains the same.

Countering Recessionary Pressures

Cross-border acquisitions prove beneficial during recessionary times. Since the impact of recession is not the same globally, such companies can supplement the decline in their earnings in one country by their earnings from other markets in other countries). Overall, the total earnings do not fall as drastically as that of companies that operate only in the local markets.

Greenfield Investments

Many countries encourage inflows of Greenfield FDI although there are stringer restrictions imposed on foreign acquisitions. Greenfield investments are encouraged as they are seen to have a positive impact on host countries. For instance, a new research and development (R&D) capacity can be developed in the host country as it creates technological spill-over benefits such as increase in income levels and consumption levels in the local markets.

DIFFICULTIES IN CROSS-BORDER ACQUISITIONS

While an increase in the number of CBAs is often interpreted as positive, the results noticed on this front are far from satisfactory. When CBA deals are examined closely, one finds that a majority of them are not successful. A study done by economists David J. Ravenscraft and William F. Long (1993) indicated that 89 acquisitions done by American companies between 1977 and 1990 did not improve the operational performance up to one year after the acquisition.

Legal Problems

The two merging entities face legal problems as they operate in different countries under different legal frameworks. The acquirer has to fulfil all the legal provisions prevalent in its home country when it acquires another company. The process is made difficult by the fact that the target company may find some legal provisions of the acquirer's country incompatible, resulting in a deadlock. For example, when

Sony Corporation acquired Columbia Pictures in 1989, it had to face numerous legal problems that stemmed from the recruitment of senior management who were under contract at Time Warner (Finkelstein 1999).

Accounting Issues

Companies often realize that the merging entities do not have similar levels and scales of internal control. Absence of internal controls results in financial mismanagement. In addition, accounting standards differ from country to country. When the merger happens, the items of the balance sheet have to be adjusted according to the norms prevalent in the acquirer's country. This makes it difficult for both the companies, as the assets may either appear to be either overvalued or undervalued. For example, when Hindustan Lever Ltd (HLL) merged with Brooke Bond India Ltd (BBIL), the two companies had to harmonize their accounting, as both the companies were following different accounting policies and internal controls. While HLL used US GAAP standards, BBIL prepared its accounts using Indian accounting standards. These two companies are no exception to this variation. Practically every CBA confronts this issue.

Weak Understanding of Fundamentals of Acquired Business

The acquirer may possess a very vague understanding of the fundamentals of the acquired business. This often drives out the anticipated synergistic benefits from the merger. For example, the failure of the merger between US Railroad, Pennsylvania and New York Central (1968), AT&T and NCR, transformation of Daimler Benz into a technology group, and the merger between Deutsche Bank and Dresdner Bank (2000) were solely because the merging entities had different visions and did not make an attempt to understand the business of the target company. This resulted in non-alignment in their visions and hence the attempts failed.

Technological Differences

This is a big problem that companies face in cross-border deals. The technology differences make integration difficult and complex. While one company would like to introduce a superior technology, the other may feel that the consumers in their country are still not ready for such technologically advanced products. This obviously poses a challenge as the former may not like to compromise on the available superior technology like the latter. For example, Columbia Pictures was in movie production, while Sony's competencies were in the movie and television business. While Sony was innovative and believed in developing and using the latest technology, Columbia was a little slow in

this respect. Each wanted to stick to its core competencies and technology, thus causing integration problems.

Strategic Issues

Companies entering into CBA have very important issues to resolve, such as deciding which products and services to offer, who will be responsible for making this happen, where cost savings would come from, the division of labour, and issues that would generate potential synergies. These issues often remain unresolved and lead to conflict between the merging entities (Finkelstein 1999).

In recent years, 'strategic' mergers have acquired a bad name, and some one have defined strategic mergers as those where the acquiring company overpays. While the price paid for a company is a critical determinant of the success of the resulting acquisition, there is no inherent reason why mergers that are statically well-conceived should fail. The merger of British Petroleum's (BP and Mobil's downstream operations across Europe is a case in point. The strategic logic for this deal says that size and market power are required to compete against the other major oil companies and even supermarket chains with gas pumps in Europe. Significant cost savings can be realized by eliminating duplicate facilities and employees, and by rationalizing purchasing and cutting overheads. Although this merger is not without significant integration challenges, it appears to have a solid strategic logic, and indeed is considered a blueprint for similar deals among rivals such as Shell, Texaco, and Amoco. It is also an unusual merger since BP and Mobil are only consolidating their refining and marketing operations in Europe, and remain rivals elsewhere. Nevertheless, estimates of cost savings are in the range of \$500 million a year, a figure which, if maintained, will clearly make this merger a success.

Fundamental Differences across Countries

The merging entities also face a set of problems arising from different cultures, values, and operating styles due to their different backgrounds, external environment, and other fundamental differences across countries. These involve corporate governance, job security, regulatory environments, customer expectations, and the country's culture. These differences add to the complexity of CBAs and make the task of managers engaged in the process more difficult. For example, the employees of the merging entities might have differences in work cultures, such as employees being accustomed to easy access to top management, flexible work schedules, or even a relaxed dress code. When the two entities merge, the new management may not approve of such practices. This may cause resentment and shrinking productivity and result in conflict between the partners.

Tendency to Overpay

The price paid by the acquirer to the target company is a critical determinant of the success of an acquisition. But many a time an acquisition goes awry because the acquirer overpays for the target company. When the anticipated synergies do not materialize or get delayed, the acquirer feels the heat and repents on the decision to acquire. The Tata's decision to acquire Jaguar and Land Rover brands is a good example. This deal is not one that would build economies of scale and help the Tata reach new markets. The deal had a different motive. For the Tata group, it was a game of reaching out to a brand with some prestige value as part of expanding its global visibility. This motivated the Tata to pay a hefty amount for the two brands, which as of now seem to be adding no great value to Tata Motors.

Failure to Integrate

Most CBAs run into difficulties because of failure in the integration process. This happens due to poor

interaction and coordination between merging firms. For example, the merger of BP and Mobil was expected to generate market power and cost savings through consolidation of their refining and marketing operations in Europe. But integration issues remained, for the two companies merged in Europe but remained rivals elsewhere.

HR Issues

Employee stress and uncertainty is a major issue in CBAs. Some employees tend to leave the merged entities, and others are laid off. Several studies conducted in this area have indicated that often employees leave the company due to attractive opportunities available elsewhere. Feelings of mistrust and stress, perceived restrictions in career plans, and changes in the organizational culture are the other contributing factors. These issues act as a barrier to the success of CBAs. For example, the merger of Bridgestone and Firestone faced tremendous HR issues. The employees of Firestone had a feeling of mistrust and stress, and perceived restrictions in career plans and attacks on established cultural traditions within the merged entity. With these issues playing in their minds, Firestone workers went on a strike when Bridgestone initiated cost-cutting measures to tackle the huge losses incurred. Had the feeling of mistrust and stress been addressed, the strike could have been averted.

CONCLUSION

Cross-border acquisitions are becoming common. Globalization and liberalization have made the business environment more conducive for them. Globalization has changed the rules of the game and managers across the globe have gained confidence to compete globally. This has been supplemented by the availability of human resources and willingness to explore business opportunities beyond national boundaries.

REFERENCES

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