CHAPTER FOURTEEN

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BUILDING GLOBAL STRATEGIES

LEARNING OBJECTIVES

After studying this chapter you should be able to:

1. Articulate the strategic advantages of globally operating firms.
2. Explain different business modes to exploit the advantages of a globally operating firm.
3. Explain why global firms engage in mergers and acquisitions and alliances.
4. Apply the institution-based view to explain patterns of acquisitions.
5. Apply the resource-based view to explain when acquisitions are likely to succeed.
6. Participate in two leading debates on acquisitions.
7. Draw implications for action.

OPENING CASE

Danisco: the evolution of a global niche leader

When in March 2009, Danisco announced the completion of the sale of its Sugar division to its German competitor Nordzucker, many Danes were rubbing their eyes. For them, the name 'Danisco' was synonymous with Sugar. What was Danisco doing now? The answer is that Danisco has been undergoing a steady transformation over 20 years. Experts in the industry and financial analysts have been following the remarkable transformation of one of Denmark's leading companies. Yet, the wider public knew little about what they actually were doing. Why? Because most people know companies with famous consumer brand names. Danisco, however, had become a market leader in business-to-business markets – apart from its now sold Sugar division.

After the transformation, Danisco was positioned as a specialized supplier of food ingredients based on natural raw materials. Its customers included global food giants such as Unilever, Kraft, Danone and Nestlé, as well as regional and local players in all major economies. Danisco specialized on ingredients that alter the properties of processed foods such as yoghurts, ice cream, sauces and bread. Its business model included not only the development and manufacture of these ingredients, but the development of applications for the ingredients jointly with customers. For example, Danisco was involved in the creation of Magnum ice cream which is successfully marketed by major brand manufacturers around the world.

Danisco's historical headquarters in Copenhagen advertise "The Danish Sugar Factories"; how does this history shape the strategies for the future?

To emphasize the innovation-driven nature of their business, Danisco adopted the slogan 'First you add knowledge'.

When the global financial crisis hit in 2008, Danisco's first priority was to advance ingredients that would help its customers save costs. A major market research project investigated how people change their food purchasing behaviour during the recession. On this basis, Danisco determined which kinds of solutions were required in specific food industry sectors; and focused its marketing on product properties that help reduce costly ingredients (like fats) or extend shelf-life. For example, they advanced a functional stabilizer that enables efficient replacement of egg without any alteration to processing lines, while also being easier and cheaper to store than liquid egg yolk.

How did Danisco become a global market leader in this niche? Danisco had been created in 1989 by a merger of three companies aiming to create a strong Danish company that could compete in the EU common market after its completion in 1992. The merger was hoped to keep traditional businesses in Danish hands, and enhance their viability. The new company was a diversified conglomerate operating mainly in Denmark and other parts of Northern and Western Europe. From the outset the company aimed to focus its profile and to strengthen its core businesses. In the first annual report (1989/1990), the corporate strategy was stated as 'to be a first-class supplier to the international food industry on the global market and be a supplier of high quality foods and branded goods on selected European markets'. Over the next years, the foods, food ingredients and packaging businesses were grown, while businesses in the machine building segment were sold.

In the sugar sector, Danisco first consolidated its dominant position in Denmark, and then grew by acquisitions around the Baltic Sea in Sweden, (East) Germany, Poland and Lithuania. The sugar market was shaped by EU regulation that aimed to protect sugar beet farmers, but that also constrained the intensity of competition and limited the scope for aggressive growth. Liberalization of this market had long been anticipated, and it finally came into effect in 2009.

In 1999, Danisco announced a new strategy focusing solely on food ingredients, and acquired Finnish ingredients manufacturer Cultor OY to cement this strategic shift. At the same time, Dansico began to sell its businesses in branded foods and food packaging including Danish icon brands like Aalborg Snaps. Two divisions thus remained: Danisco Ingredients was developing, manufacturing and distributing emulsifiers, stabilizers, flavours and enzymes, while Danisco Sugar dominated northern European sugar markets. During this transformation, the internationalization of sales rapidly increased, with sales outside Denmark rising from 69 per cent 1995 to 88 per cent in 2004 and over 95 per cent after the sale of the sugar division. In 2009, Danisco generated €1.7 million turnover, of which 38 per cent came from Europe, 40 per cent from the Americas and 17 per cent from Asia-Pacific. Danisco employed 6800 people in 17 countries, in part to serve local markets, such as China, and in part to process natural ingredients only found in specific locations, such as Chile. Expansion in Europe, North America and Australia occurred mainly through acquisitions, while business in emerging markets grew to a larger extent by greenfield projects.

The sale of the sugar division in 2009 thus was the logical consequence of the two-decade long transformation process. The synergies between the sugar and ingredients sectors had diminished, while liberalization of the EU sugar regime led to the expectation of changing competitive dynamics in the sector. However, before completing the sale to Nordzucker AG of Germany, clearance needed to be obtained from competition authorities in those countries where both Nordzucker and Dansico held substantive market shares.

Sources: Based on Cortzen, J. 1997. *Merchants and Mergers: The Story of Danisco*, Copenhagen: Børsens Forlag; Meyer, K.E. and Møller, I.B. 1998. Managing Deep Restructuring: Danish Experiences in Eastern Germany, *EMJ*, 16: 411–421; Meyer, K.E. 2006. Globalfocusing: From domestic conglomerate to global specialist, *JMS*, 43(5): 1109–1144; Danisco (various years): Danisco annual reports; Danisco (2009): Latest News, www.danisco.com (accessed March 2010).

Why did Danisco change the focus of its business so drastically? Why did it make aggressive acquisitions around the world, while selling some of its former core businesses? How do companies like Danisco create value in such dispersed yet integrated operations around the world? The diversity of the global economy creates both challenges and opportunities for companies transcending borders and

Global strategies
Strategies that take advantage of operations spread across the world.

continents. This chapter focuses on the opportunities of global strategies, and how companies can make best use of the diversity of the world. Global strategies take advantage of operations spread across the world, they do *not* imply that the company is present everywhere, or that different parts of the world are equally important. In fact, most companies with global strategies have a major share of their operation close to their origins.

AAA typology
Aggregation, adaptation and arbitrage strategies.

We first summarize different types of advantages that firms may be chasing when they develop global strategies. Then, we introduce the AAA typology of strategies that illustrates different ways in which firms can create value by integrating operations across countries: aggregation, adaptation and arbitrage.[1] Thereafter, we explore how firms use acquisitions to develop the kinds of global operations that allow them to deploy these strategies on the global stage, and discuss how institution- and resource-based views help explain the patterns and performance of acquisitions. Debates and extensions follow.

COMPETITIVE ADVANTAGES OF THE GLOBAL FIRM

LEARNING OBJECTIVE

1 Articulate the strategic advantages of globally operating firms

International operations can help multinational enterprises entrepreneurships (MNEs) to develop competitive advantages in several ways, providing MNEs an edge over firms that operate only in a single country (Table 14.1).[2] Not every MNE exploits all of these potential advantages, but many benefit from several of them. Their relevance varies with the nature of the industry and the company's business models.

Global scale

Economies of scale
Reduction in unit costs achieved by increasing volume.

A basic advantage of MNEs over their typical domestic rivals is simply their size. Advantages of size are known as economies of scale, that is the reduction in unit cost that is achieved by increasing the volume of production. In manufacturing, economies of scale arise from higher capacity utilization, or from larger production facilities. Thus, the fixed costs of setting up a factory or a production line are distributed over a larger number of products. Large volume production thus reduces the costs of each unit. MNEs selling from a single manufacturing facility to many countries thus achieve economies of scale in their production.

In addition, scale advantages at other stages of the value chain are of increasing importance in the 21st century. In particular, MNEs may share their costs of

Table 14.1 Strategic advantages of global firms

- global scale advantages reduce costs in production, product development and marketing
- global sourcing provides access to a wider range of inputs
- global knowledge management enhances innovation
- global operation allows better servicing of global customers
- risk diversification reduces the corporate risk profile

designing and developing new products across products manufactured and sold at multiple locations. In sectors such as the car industry, these scale advantages of development can be enormous. Selling more cars by serving many countries thus makes a big difference to the price the manufacturer has to charge to recoup their R&D investment. Even if cars produced around the world vary in their design, they may share a common platform of technologies and components, which greatly reduces the development costs of new models.

Scale economies also arise in numerous other activities. For example, the volume of purchasing increases bargaining power vis-à-vis suppliers. Like in your weekly shopping, bulk buying reduces the unit prices paid by MNEs purchasing components or raw materials. Similarly, the scale of global brands reduces costs of development and marketing a brand.

Global sourcing

Businesses operating on the global stage can access resources in a variety of locations. Hence, they can source every input where it is available at the best quality or the lowest price. Exploiting even small cost differences, especially for raw materials, components and labour can make a substantial difference to a firm's cost structure – provided they are not eaten up by transport costs. Moreover, global sourcing enables firms to access specific qualities of raw materials available only at a limited number of locations. For example, Danisco (see Opening Case) set up a specialized plant to processes specific types of algae that were only available in the sea off the coast of Southern Chile.

Global sourcing Buying inputs all over the world.

Bringing together operations at different locations in a single organization, MNEs thus can exploit comparative advantages (Chapter 5). Exporters and importers also exploit comparative advantages, yet MNEs do so internally, which enhances their operational flexibility by allowing smooth shifts of production from one site to another should circumstances change.[3] Especially activities that have low set-up costs can be moved in response to, for example, changes in exchange rates or labour costs.[4] MNEs can organize production geographically dispersed, yet integrated in a global supply chain.

Global innovation and knowledge management

Global companies can spread their research and development (R&D) units to tap into capabilities available at different sites. For example, a presence in Silicon Valley, California provides access to latest ideas in information technology, while biotechnology firms cluster around Cambridge, England or Copenhagen, Denmark. At the same time, innovation centres around the world provide exposure to different customer expectations when developing new products or services.

MNEs with dispersed yet inter-connected centres of excellence thus can reap several benefits. First, they can overcome the potential replication and inconsistency of standards that may evolve in case of disconnected R&D operations. Second, the interaction between research units at different locations enhances creativity and idea generation, and thus innovation. Third, centres of excellence allow exploitation of comparative advantages in for example specialized human resources, such as IT skills in India. A study by consultants Booz & Company demonstrates these benefits empirically. They show that international linkages between R&D units, rather than increased R&D spending per se, enhance innovation MNEs that deployed more than 60 per cent of their R&D outside their home countries were found to perform better on several indicators.[5]

Centres of excellence Specialized centres for innovation that serve the entire MNE.

Moreover, global operations allow companies to share and exploit knowledge better than firms with only arm's-length relationships across borders.[6] MNEs connect people and businesses that operate in different environments, yet may face similar business challenges. Bringing these people together within one organization allows them to exchange knowledge, experiences and competences, which in turn facilitates the creation of new innovations and competencies. Global knowledge management thus allows firms to create a shared pool knowledge that supports each individual operation. Chapter 15 explores some of the operational challenges of global knowledge management.

Global customers

Global key accounts Customers served at multiple sites around the world, but that negotiate centrally.

Global operations are especially valuable when it comes to serving customers that themselves are operating at multiple locations. Such global customers, also known as global key accounts, may source their inputs internationally. In other words, they negotiate contracts with suppliers who would provide the same product or service at multiple sites. The automotive industry has been at the forefront of developing supply networks on a global scale. Manufacturers work closely with suppliers when developing new models, and expect them to deliver modules or components at any of their assembly sites. Danisco (Opening Case) similarly is developing relationships with global key accounts such as food manufacturers Nestlé, Danone and Unilever. Also, many business services, such as consultancy, accounting or advertising work with global key accounts.[7] Firms with a global distribution network and production sites close to key locations of their customers have a distinct advantage in serving such global customers.

Diversification of risk

Operations in multiple countries also reduce the financial risk profile of the overall company. Like portfolio investment, sales revenues from a variety of sources reduce the overall risk profile as long as they are less than perfectly positively correlated. It is rare that a recession hits every country at the same time. Thus, companies with global sales may be able to shift the focus of their activities to locations that are doing relatively well. In consequence, their global sales are less volatile over time than sales generated in a single market. Similarly, locating production at multiple sites reduces exposure to adverse events affecting any particular site, including not only economic events (such as a recession) but also natural disasters, wars and terrorism or a flu pandemic. With increased frequency of unexpected events disrupting global trade, risk management practices that allow companies to react flexibly to the unexpected can be a vital competitive advantage.

GLOBAL BUSINESS MODELS

LEARNING OBJECTIVE

2 Explain different business modes to exploit the advantages of a globally operating firm

Global strategies provide competitive advantages to companies that think and act on the international stage, rather than in a single country. In view of these advantages, scholars have been arguing for MNEs to globalize their offerings. The origins of this movement can be traced to a 1983 article published by Theodore Levitt, with a self-explanatory title: '*The Globalization of Markets*'.[8] Levitt argued that there is a worldwide convergence of consumer tastes. As evidence, Levitt pointed out Coke Classic, Levi Strauss jeans and Sony colour TVs, which were successful on a worldwide basis. Levitt predicted that such convergence would characterize most product markets in the future.

Figure 14.1 AAA Strategies

Source: Based on '*Redefining global strategy*' by P. Ghemawat, 2007, Harvard Business School Press, copyright © Harvard Business School Publishing, 2007. Reproduced with permission.

Levitt's article has often been used as the intellectual underpinning propelling many MNEs to globally integrate their products while minimizing local adaptation. Ford experimented with world car designs. MTV pushed ahead with the belief that viewers would flock to 'global' (essentially American) programming. Unfortunately, most of these experiments have not been successful. Ford finds that there are wide-ranging differences among consumer tastes around the globe. MTV has eventually realized that there is no global song. In a nutshell, one size does not fit all.[9] As we discussed in Chapter 1, globalization is about more intensive interfaces, not necessarily about convergence. Hence, global strategies are about making use of differences as well as communalities around the world. But how?

There is no single strategy that suits every firm – in fact coming up with a business idea that no one else has yet has thought of is a good basis for success. To classify business models, Harvard and IESE Professor Pankaj Ghemawat introduced three types: Arbitrage, Aggregation and Adaptation[10] (Figure 14.1). These strategies are not exclusive as many MNEs combine aspects of two or even all three strategies. However, trying to realize all three strategies at the same time may well overstretch organizational capabilities. Thus, choosing the right strategy is about finding a business model that best fits the specific firm, and its global competitive environment.

Aggregation strategy

An aggregation strategy focuses on the realization of synergies between operations in different locations by integrating them above the national level. It does not necessarily imply standardization, it may simply involve sharing of resources and integration of processes. For example, R&D laboratories serving a variety of activities may be pooled at a small number of strategic locations. Aggregation strategies are designed to exploit economies of scale, and to foster innovation and knowledge management. At the same time, activities that are best done differently may be located close to local resources and customers. For example, product development, sourcing and finance are often handled in regional or global business units, while sales, marketing and human resources are typically managed locally.

Aggregation strategy Strategy of realizing synergies between operations at different locations.

Aggregation may imply global centralization at headquarters (especially in smaller businesses), but not necessarily. Aggregation is often regional rather than global, thus reflecting the regional nature of much business. Global brand companies like Dell and Toyota in fact have supply chains that are region-based with separate hubs in Asia, Europe and North America.[11] Large organizations can vary their

levels of aggregation, say global R&D, regional supply chains and local sales operations to fine-tune operations. Such varied aggregation allows optimizing synergies, yet it also increases complexity and thus cooperation challenges.

Aggregation is often associated with geography: country, region and global. But it can also follow other patterns. For example, cultural, administrative and linguistic communalities are important in consultancy and call-centre-based services. They may pool customers sharing a common language if communicating in the customers' own language is essential for the quality of their services. Alternatively, they may locate where qualified staff fluent in many languages are readily available. For instance, the Greater London area offers a multilingual workforce due to immigration from a wide range of countries and cultures. Other businesses may aggregate along levels of income as product design and marketing practices depend on how much consumers can afford.

Adaptation strategy

Adaptation strategy
Strategy of delivering locally adapted products in each market.

An **adaptation strategy** aims to deliver locally adapted products in each market. It thus allows serving consumers on their local terms despite differences in their needs, preferences and purchasing power. Adaptation is particularly important when entering distant countries, such as European businesses entering East Asia. In emerging economies, adaptation to local customers may take into consideration in particular (1) lower incomes, (2) higher variability of customer groups and (3) lower labour costs.[12] First, low incomes imply that marketing strategies imported from developed countries may not work: TV and internet advertising may not reach the target audiences cost-efficiently. Moreover, products designed in Europe may be too expensive or too complex, even if produced locally. Second, variations within the country may require even more fine-grained adaptations, for examples between rural and urban areas. Third, low labour costs create opportunities for business models that rely more on people, for instance by substituting capital-intensive sales and distribution processes by more labour intensive ones: sales assistants may hand out free samples to target customers, or promote drinks in restaurants and bars. Such an approach would be prohibitively expensive in Western Europe.

Yet adaptation does not mean that everything is done locally, or done differently in every country. MNEs can achieve variation without giving up the benefits of a global company. Ghemawat proposes four levers of adaptation (Table 14.2):[13] First, companies may focus on those activities and products where only a minimum of adaptation is required. For example, fast moving consumer goods MNEs may focus on young urban consumers whose consumption patterns vary less across countries than older or rural populations. Firms may also focus on stages of the value chain that require less adaptation, or sell the same product but position it in a different segment. A standard product from Western Europe may be positioned as a premium brand in an emerging economy, and thus be sold using different marketing and sales processes.[14] For example, Heineken and Carlsberg are considered mainstream beer brands in their home countries, yet in countries such as Vietnam they compete for leadership in the premium segment.[15]

Second, MNEs may externalize the costs of adaptation by working with local partners that contribute investment and local knowledge. For example, they may focus on business-to-business segments providing high-value added components that are incorporated variety of customized products by local firms. Other MNEs, such as McDonalds or KFC, have developed franchising models that empower local franchisees to vary products within the scope of the corporate brand and to carry the costs and risks associated with such adaptation.

Table 14.2 Levers of adaptation

Ideas	Examples
• Focus on activities and products that require less adaptation across markets	• Marketing to young urban consumers with cosmopolitan values • Specialize in technologies or components used in a variety of final products
• Externalize the costs of adaptation by working with local partners	• Allow local franchisees and distributors to modify products and service delivery • Enable users to modify the products to fit their needs
• Design the basic product in ways that increase flexibility of the final product to be produced for different markets	• Design products with shared platforms that economize on base technologies • Design modular products that can be variously combined for different purposes
• Organize innovation processes with effectiveness of variation in mind	• Localize innovation to capitalize on local knowledge • Recombine competences across the multiple locations

Source: Based on P. Ghemawat, 2007, *Redefining global strategy*, Boston: Harvard Business School Press.

Third, **adaptability** can be achieved through business models designed to share some communalities, but allow for adaptation to specific user groups or locations. For example, car manufacturers have developed their models around platforms and modules that allow production of a wide range of different cars with a small range of components and technologies. Fourth, local innovation allows creation of new products by locally knowledgeable people that can combine competences of the MNE with ideas available in the local context, and geared towards local needs. This increases variety of products without stretching central research and development units.

Arbitrage strategies

An arbitrage strategy exploits differences in prices in different markets. Prices for many goods vary across countries, which provides the basis for international trade (see Chapter 5) and provides many opportunities to earn money by moving products from one location to another. MNEs may be better positioned to exploit arbitrage as their subsidiaries can access local markets directly.[16]

Arbitrage strategy Strategy of exploiting differences in prices in different markets.

Traditionally, arbitrage strategies opportunities were associated with labour, capital and natural resources. Strategies of labour arbitrage exchange the services of a labour force, and thus allow exploiting low cost labour or specialist human capital. Capital arbitrage is less common as financial markets are generally more efficient. Yet, some companies found ways to access capital at lower costs in foreign capital markets that are more internationalized and liquid. For example, many Chinese companies list on the Hong Kong stock market, while South African firms such as SABMiller list in London. Natural resource arbitrage exploits variation in geology and climate to trade energy resources (such as oil, gas and coal) minerals

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How does the mining industry compete globally?

(such as copper, aluminium, zinc, gold, silver, diamonds) as well as agriculture, forestry and fishery products.

Location-bound humans capital also gives rise to arbitrage of knowledge-intensive services For example, educational institutions – from boarding schools and language classes to universities – sell their services to students, who come to their classrooms from all parts of the world. Similarly, entertainment experiences attract global audiences, such as musicals in London and New York, opera in Milan and Verona, or gambling in Monaco, Las Vegas and Macau. Similarly, medical services for patients worldwide are provided by hospitals in Singapore, Thailand, South Africa (beauty treatments!) and Eastern Europe who offer operations at much lower prices than for example in Western Europe.

Even used goods and waste can be an opportunity for arbitrage. Do you know how the world's richest self-made women, Cheung Yan, made her millions? From used paper![17] She is running the biggest paper mill business in the world by recycling paper from the USA in China. Now you may wonder how it can be worthwhile to ship paper all the way across the Pacific. Well, think of the US trade deficit. For years, the USA have been importing more products than they have been exporting. Full ships have crossing the Pacific eastbound, and returning comparatively empty westbound. Thus, freight rates from the USA to China have been rather low, making it economically viable to ship low value products. The diversity and communalities across the world thus provide a basis for a wide range of business models for firms with internationally dispersed operations.

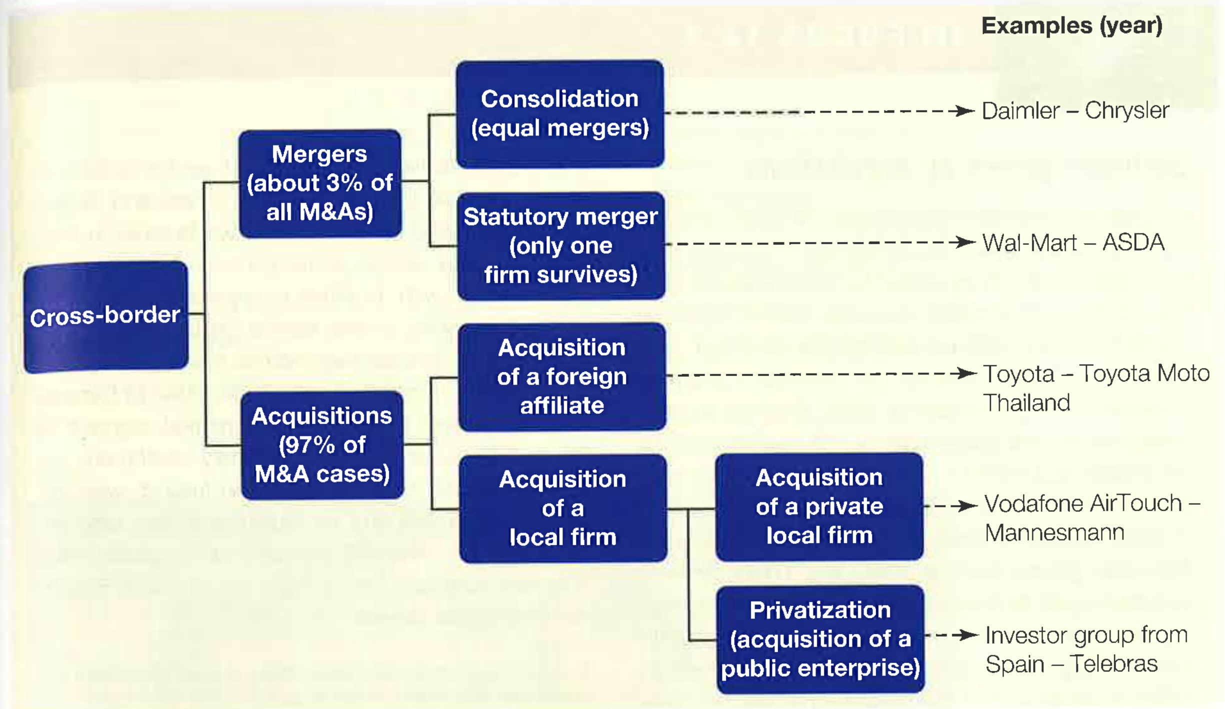
LEARNING OBJECTIVE

3 Explain why global firms engage in mergers and acquisitions, and alliances

GROWTH BY ACQUISITIONS

Global operations provide competitive advantages, yet how do firms build global operations? One possibility would be organic growth with successive opening of new operations across the world. However, few firms choose this path – it simply

Figure 14.2 The variety of cross-border mergers and acquisitions



Source: 'The Variety of Cross-Border Mergers and Acquisitions' adapted from World Investment Report 2000 (p.100), www.unctad.org, United Nations is the author of the original material. Copyright © United Nations, 2000. Reproduced with permission.

takes too much time. Companies with global ambitions thus typically grow through mergers and acquisitions (M&As).

An acquisition is a transfer of the control of operations and management from one firm (target) to another (acquirer), the former becoming a unit of the latter. For example, Danisco (Opening Case) acquired Cultor of Finland and integrated it in its own operations; Cultor ceased to exist as a firm. A merger is the combination of operations and management of two firms to establish a new legal entity. For instance, the merger in 2005 between Interbrew (Belgium) and Ambev (Brazil) created Inbev, which merged in 2009 with Anheuser Busch (USA) to form AB-Inbev. However, only 3 per cent of M&As are mergers (Figure 14.2). Even many so-called 'mergers of equals' turn out to be one firm taking over another. A recent *World Investment Report* opines that 'The number of "real" mergers is so low that, for practical purposes, "M&As" basically mean "acquisitions".'[18] Consequently, we will use 'M&As' and 'acquisitions' interchangeably.

Most large M&As are cross-border (international) M&As; they account for approximately 30 per cent of all M&As. In 2007 (a record year), M&A deals topped €2.9 trillion, of which €1.3 involved European companies. During the recession of 2009, the worldwide value of M&As dropped to €1.5 trillion, reflecting the lower asset prices, mirroring a similar drop after the 'internet bubble' of 2001 when M&A volume fell from €2.4 trillion to €0.9 trillion.[19] M&As represent the largest proportion of FDI flows, reaching approximately 70 per cent of worldwide FDI. Most of the largest MNEs of the world have grown by acquisitions, as have many MNEs from emerging economies that recently entered the global stage, such as Brazilian Embraer (In Focus 14.1) and Indian Bharti Airtel (Chapter 6, Closing Case).

Acquisition
The transfer of the control of operations and management from one firm (target) to another (acquirer), the former becoming a unit of the latter.

Merger
The combination of operations and management of two firms to establish a new legal entity.

IN FOCUS 14.1

Embraer grows by acquisitions

Embraer is a Brazilian manufacturer of small commercial and military aircraft. It was originally established as a manufacturer of military aircraft by the Brazilian state in the 1960s, and invested overseas (United States in 1979, Europe in 1988) primarily to offer sales and technical support to customers in developed markets. However, after privatization in 1994, Embraer aggressively entered the commercial aircraft market focusing on smaller and medium size jets. To build its competences in this segment, especially from 1999 onwards, it entered into a series of strategic alliances with European groups such as EADS and Thales (France) in order to gain technology (and to reduce risk by pooling resources). Later it made acquisitions to ensure brand recognition in specialist aerospace markets. In 2004, it established a manufacturing affiliate in China (in which it owns a 51 per cent stake), which assembles final aircraft for the Chinese and regional market. In 2009, Embraer had production and service facilities in Brazil, the USA, France, Portugal, China and Singapore, and started construction of two factories in Portugal to make aircraft frame parts and carbon fibre components, with production expected to start in 2012. Meanwhile, a new service centre in India was opened to serve customers across Asia.

Embaer is competing with Bombardier of Canada for world market leadership in the market segment of 70 to 100-seater aircraft. Its primary customers are regional airlines such as Jetbird in Ireland, who ordered 100 aircraft and Air Dolomity in Italy who ordered 30 jets. With 90 per cent of its global sales overseas, Embraer can be regarded as one of Brazil's few truly global players.

Sources: Based on: (1) *BBC News*, 2005, Embraer shows Brazil's aviation flair, http://news.bbc.co.uk (accessed March 2010); (2) United Nations, 2006, *World Investment Report 2006* (p. 159), Geneva: United Nations; (3) P. Blum, 2009, Brazilian jet maker expects to outlast crisis, *New York Times*, June 15.

Motives for acquisition

Synergies
Value created by combining two organization that together are more valuable than the two organizations separately.

What drives acquisitions? Table 14.3 shows three drivers: (1) synergies, (2) hubris, and (3) managerial motives.[20] First, synergies between two merging organizations mean that the new organization is more valuable than the two organizations separately, for example because only one central administration and one distribution channel is needed. Acquisitions may help firms to build the global operations they aspire, adding for example complementary market positions, production facilities or operational capabilities. The strategic complementarity of the resources of the two (or more) organizations thus forms the basis for synergies, and thus for the creation of value in the M&A.[21]

For example, when MOL, the Hungarian integrated oil refinery and distribution company, took over its Slovakian counterpart Slovnaft, it identified a wide range of synergies, including optimization of refinery production, linking of logistics networks, shared R&D, coordinated sales and marketing and integrated financial management. However, not all these synergies could be realized, for example in the area of logistics, while synergies in marketing and finance exceeded expectation.[22] The realization of synergies is a challenging managerial task that only some firms have mastered.

A related M&A driver is to establish a strong market position, or to enhance market power.[23] Mittal Steel's acquisition of European market leader Arcelor in 2007, propelled the Indian-owned MNE into a global leadership position with almost 10 per cent of world steel output. Arcelor's high-tech steel plants, particularly in France and Belgium, added new capabilities to Mittals's existing less sophisticated

Table 14.3 Motives for acquisitions

Synergistic motives	• Leverage superior organizational capabilities • Enhance market power • Reduce costs by eliminating duplicate units and exploiting scale economies • Access to complementary resources
Hubris motives	• Managers' overconfidence in their capabilities
Managerial motives	• Self-interested actions such as empire building and bonuses

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Why do you think Lufthansa acquired Austrian Airlines in 2008?

facilities, and enabled it to raise the quality of its products, especially for technologically demanding buyers, such as the car industry. Moreover, the acquisition gave Mittal a bridgehead into new Latin American markets.[24]

While synergistic motives, in theory, add value, other motives can reduce shareholder value. **Hubris** refers to managers' overconfidence in their capabilities.[25] Managers of acquiring firms make two strong statements. The first is, 'We can manage *your* assets better than you [target firm managers] can!' The second statement is even bolder. Given that acquirers of publicly listed firms have to pay an acquisition premium, this is essentially saying: 'We can achieve something no one else can'. Capital markets are (relatively) efficient and the market price of target firms reflects their intrinsic value. Yet, an acquirer offering a premium suggests to create more value in the acquired firm than other owners, usually due to expected synergies. Empirical studies, however, show that very often the premium is too high, and

Hubris
A manager's overconfidence in his or her capabilities.

acquiring firms have overpaid.[26] For example, Kraft was widely believed to have overpaid for British chocolate maker Cadbury in 2010 as outside observers wondered how Kraft would be able to realize the synergies implied in its acquisition premium. One explanation of this frequent overpayment is that managers – often encouraged by their financial advisors – overestimate their own abilities.

While the hubris motives suggest that managers may *unknowingly* overpay for targets, managerial motives posit that for self-interested reasons, some managers may *knowingly* overpay for target firms in their personal quest for more power, prestige and money. This behaviour is caused by agency problems. Managers as 'agents' are supposed to act in shareholders best interest, yet they can use their inside knowledge to advance their own goals because shareholders lack effective mechanisms of control. While managerial self-interest is usually hard to prove, it is often suggested by opponents of a deal. For example, when German state railway company Die Bahn took over British bus and train operator Arriva, several politicians suggested that managers were pursuing their own interests rather than those of the owners, in this case the German state.[27]

Acquisitions versus alliances

Strategic alliances
Collaborations between independent firms using equity modes, non-equity contractual agreements, or both.

An alternative to a full take over of another firm is a collaboration with that firm, also known as a strategic alliance. We already discussed one form of strategic alliance, namely joint ventures (JVs) as a means to enter new markets (Chapter 12). Here we look at two further forms of strategic alliances: (1) business unit joint ventures (JVs), and (2) joint production, marketing or distribution arrangements.

First, some major MNEs pool their activities in specific industry segments with a competitor or another firm offering complementary resources. For example, Ericsson formed a JV with Sony to develop and market mobile phones, combining Ericsson's technological expertise and Sony's design competences. Similarly, Nokia has pooled is network operating systems with Siemens and Siemens pooled its white goods business with Bosch in Bosch-Siemens Hausgeräte, while competing with Bosch as an automotive supplier. Why do companies engage in such business unit JV under shared ownership?

Business unit JV
A JV in which existing business units from two firms are merged.

Like other JVs (Chapter 12), business unit JVs draw on competences of two (or more) parent firms. They are an attractive options if three conditions are met: First, two entities can together achieve something that neither could achieve on its own, for example market leadership in their industry or next-generation innovations. Second, the merged unit depends on inputs such as technologies from both parent firms that may be disrupted by legal separation (in other words, market transaction costs are high). Third, a full take-over is not feasible, perhaps because the competition authorities would object – see next section. Divisional JVs can develop a life of their own and become long-running success stories in their industry: Nokia Siemens Networks, Bosch Siemens Hausgeräte and Sony-Ericsson Mobile Phones have been key players in their industries for several years. Even longer, Fuji Xerox, a Japanese-American JV has been manufacturing printers since 1962. In other cases, JVs are discontinued when the original purpose has been achieved. For example, HP and Ericsson created a JV at a time when telecommunications and computer industries were merging. They set out to jointly develop new technologies to conquer the emerging telecommunications network market. After several years of a volatile relationship, these objectives were achieved and Ericsson took over the JV.[28]

Operation collaboration
A form of strategic alliance that includes collaboration in operations, marketing or distribution.

Second, a strategic alliance may consist of far-reaching operational collaboration, yet stopping short of full acquisition. Such alliances are common for example in the airline industry, where national flag carriers have formed alliances that allow them to connect to all major travel destinations. Their collaboration includes, for

example, code sharing and shared frequent flyer programmes, which enables both (or more) partners to offer services that draw on resources of the partner. For example, when buying a Lufthansa ticket from Germany to the UK, you may actually be flying on a British Midlands aircraft.

Strategic alliances may also serve to prepare a full acquisition. Alliances cost less and allow for opportunities to learn by working with each other before a take-over.[29] Acquisitions are often one-off deals swallowing both the excellent capabilities and mediocre units of target firms, leading to 'digestion' problems.[30] Many acquisitions (such as DaimlerChrysler) probably would have been better off had firms pursued alliances first.

INSTITUTIONS GOVERNING ACQUISITIONS

LEARNING OBJECTIVE

4 Apply the institution-based view to explain patterns of acquisitions

Mergers and acquisitions are subject to formal and informal institutions such as restrictions on foreign ownership (Chapter 12), often simultaneously in several countries. Managers pursue M&As to enhance the profitability of their firms (or to further their personal interest), yet such mergers are not necessarily in the best interest of society. Therefore, legislators have created anti-trust laws that merging firms have to respect in every market in which they are operating. For example, when US firms GE and Honeywell wished to merge in 2001, the European Commission intervened fearing negative implications for European markets. However, authorities use different processes and criteria to approve or disallow proposed mergers, which implies that multiple approvals may be required. In the GE-Honeywell case, this led to conflicting decisions in Europe and the USA.[31] Eventually, the Commission lost its case in the courts, and GE and Honeywell were allowed to merge. Subsequently, the EU has refined its processes and guidelines and hired more economists specializing in competition analysis, which contributes to convergence of regulatory practice in the EU and the USA. Thus, merging firms now act within a somewhat clearer and more predictable institutional framework.[32] For businesses contemplating an M&A, the key concerns are (1) what are regulators looking for in horizontal M&As? (2) what are regulators looking for in vertical M&As? and (3) how can merging companies get approvals even when there are initial concerns?

Horizontal M&A

The key criterion for M&As within the same industry is whether the removal of competition will allow the merging companies to raise prices after the merger (Table 14.4). Traditionally, the main way to assess this criterion has been the joint market share. Yet, in recent years regulators have shifted to also consider potential positive effects of reduced costs and accelerated innovation for consumers. Moreover, the definition of the market focuses on substitutability of the products and services, as many competitors are not exactly in the same market, but sell close substitutes. These assessments based on new methods of economic analysis that had first been introduced in the USA, and are increasingly applied by the EU as well. For example, the European Commission prohibited the merger between Irish airlines Ryanair and Air Lingus, who both had their main hub in Dublin and together accounted for 80 per cent of passengers on many short-haul routes between Dublin and European destinations. Ryanair argued that it is operating in a different market segment, 'budget travel', and its customers choose between not travelling *versus* Ryanair rather than Ryanair *versus* Air Lingus. The Commission investigated this claim not only by economic analysis with by a questionnaire survey of passengers

Table 14.4 What regulators are looking for when assessing mergers and acquisitions

Horizontal M&A	Vertical and Conglomerate M&A
Will the merged firm attain a dominant market share?	Will the merged firm have the ability to use its control over multiple stages of the value chain to limit access to suppliers or customers for competitors operating in only in one stage?
Will consumers benefit from cost savings or accelerated innovation in the merged firm?	Will the merged entity have economic incentives to behave in such manner?
Will the removal of competition enable the merged firm to raise prices?	Will such behaviour give rise to significant impediment to effective competition?

using Dublin airport, and ruled that indeed the two companies were direct competitors, and thus the merger was not allowed to go ahead.[33]

Companies know these rules, and they design their acquisition strategies accordingly. For example, Heineken (Netherlands) had long wished to take over Scottish and Newcastle (S&N) to enter the attractive UK beer market. Yet in other countries such as France, they both held large market shares, and the competition authorities would not have approved the merger. Meanwhile, Carlsberg was keen to acquire S&N because of their co-owned business in Russia and other attractive operations in emerging economies. Yet, the British authorities would not have approved a merger of two of the four largest brewers in the UK. Thus, Heineken and Carlsberg launched a surprise *joint* attack: They acquired S&N, and then sliced it up in such a way that no national competition authority would have reasons to object. Thus, Heineken took over the operations in the UK, Finland, Belgium and Portugal, while Carlsberg took over S&N's share in the joint operation in Russia as well as businesses in France and Greece. The Kronenbourg brand thus is now being owned by Carlsberg in France, and by Heineken in the UK. Otherwise, the two archrivals continue to compete in many countries, softened by even stronger multipoint competition.

Vertical M&A

Vertical acquisitions tends to give less rise to competition concerns as efficiency gains between the partners are more likely due to the cost reductions that come with the internalization of markets. Usually, vertical mergers do not lead to a loss of direct competition. However, competition authorities may intervene if the merged entity is able to use its control over multiple stages of a value chain to make it harder for rivals competing only in one of the stages. For example, a vertically integrated company with dominance in the upstream stage may make it more difficult for rivals who compete in the downstream stage, because they would depend on the merged firm's inputs ('input foreclosure'). As a hypothetical example, if a dominant supplier of essential goods, such as milk, was to acquire a retail chain, the competition authorities may object because they fear that the merged firm might use its control over the milk market to the disadvantage of other retailers.

Likewise, a vertically integrated firm with dominance over the downstream stage may make it difficult for companies competing only in the upstream segment because they would have to sell to one their competitors ('customer foreclosure'). As a hypothetical example, an electricity grid operator that also operates power plants

may grant competing power generators access to its network under less favourable conditions than its own plants. Thus, a vertical integration between a network operator and its suppliers would be a concern to competition authorities. When assessing vertical mergers, the European Commission would look for ability, incentives and detrimental effects of such behaviours (Table 14.4). In practice, these issues are important in the assessment of anti-competitive behaviour (Chapter 13), yet there have been few blocked vertical mergers, apart from the GE-Honeywell case.

Remedial actions

If a regulator is concerned that a merger negatively affects competition, it can (1) prohibit the merger, (2) ask for divestment of selected operations or (3) ask for commitment to specific actions that ensure competition.

First, an outright prohibition is the simplest solution, because it is easiest to implement and monitor, yet it does not allow the merging partners to achieve their goals. Second, the regulators may ask the merging firm to sell a business unit to ensure that competition is maintained in a particular market. This solution is however more tricky than might seem at first sight: it is essential that the sold unit is a viable business that will emerge as a substantive competitor in the hands of the new owners. As many businesses depend on knowledge transfer, licences or distribution channels shared with their parent firm, this condition is not easy to meet. If the regulator forces a sale, the merged firm has incentives to create a weak competitor that does not pose a substantial threat. For example, when Carlsberg merged with the brewing activities of Norwegian conglomerate Orkla, the Lithuanian authorities forced Carlsberg to sell one of its breweries in the country. Carlsberg complied by selling the brewery to a small Danish brewery with few international activities, making sure not to let any of its global rivals into this small but highly profitable market.

Third, the regulator may impose behavioural constraints, such as a commitment to give rivals access to critical infrastructure on a non-discriminatory basis, or to licence technologies. Such a commitment was used for example when Vivendi, the owner Canal+, merged with Seagram, which owned Universal, one of Hollywood's prime movie studios. Concerns were raised that preferred access of Canal+, a leading pay-TV operator, to Universal's movies would make life more difficult for competing pay-TV operators. Thus, the merging parties committed not to grant Canal+ 'first window rights' covering more than 50 per cent of Universal's new releases.[34] Such commitments are naturally difficult to assess and to monitor; thus regulators see them as a less preferred option.

A major concern of businesses about the competition policy is that the Commission has to deal with very complex matters, yet it has far fewer people working on these issues than comparable authorities in the USA. Thus, rulings are often less evidently supported by sophisticated economic analysis (a nice revenue earner for economics professors in the USA) and may take quite some time, especially if they are challenged in the European Court of Justice. In response to such criticism, the Commission has increased the resources it has allocated to its competition policy monitoring work.

RESOURCES INFLUENCING ACQUISTION PERFORMANCE

LEARNING OBJECTIVE

5 Apply the resource-based view to explain when acquisitions are likely to succeed

Value-destruction?

Do acquisitions create value? Obviously, managers believe they would add value, mainly by exploiting synergies. However, the overall performance of M&As is

sobering. As many as 70 per cent of acquisitions reportedly fail. On average, acquiring firms' performance does not improve after acquisitions.[35] Target firms, after being acquired and becoming internal units, often perform worse than when they were independent firms. The only identifiable group of winners is shareholders of target firms, who may experience increase in their stock value during the period of the transaction – thanks to the acquisition premium (the difference between the acquisition price and the market value of target firms).

Acquisition premium
The difference between the acquisition price and the market value of target firms.

Acquirers of EU firms on average pay an 18 per cent premium, and acquirers of US firms pay even more, 20 to 30 per cent premium.[36] Shareholders of acquiring firms experience a 4 per cent loss of their stock value during the same period. The combined wealth of shareholders of both acquiring and target firms is marginally positive, less than 2 per cent.[37] Thus, on average, M&As destroyed value.[38] Consider DaimlerChrysler. In 1998, Daimler paid $35 billion, to acquire Chrysler, a 40 per cent premium over market value. The high premium is an indication of (1) strong capabilities to derive synergy, (2) high levels of hubris, (3) significant managerial self-interests or (4) *all of the above*. In 2007, Chrysler was sold to Cerberus Capital, a private equity firm, for $7.4 billion – four-fifths of the value had been lost (either Daimler over-paid, or value was destroyed after the acquisition). For another example, in 2006, Google paid $1.6 billion to acquire YouTube, a 20-month-old video-sharing site with *zero* profits. Microsoft CEO Steven Ballmer commented that 'there's no business model for YouTube that would justify $1.6 billion'.[39]

Value-creation

In the presence of so much apparent value-destruction, how can acquirers actually create value in M&As? Successful M&As have to address numerous challenges in both pre- and post-acquisition phases (Table 14.5). Firms with capabilities to manage these processes are able to create value in acquisitions, even when others cannot.

Table 14.5 Causes of acquisition failures

	Problems for all M&As	Particular problems for cross-border M&As
Pre-acquisition: Overpayment for targets	• Managers overestimate their ability to create value • Inadequate pre-acquisition screening • Poor strategic fit	• Lack of familiarity with foreign cultures, institutions and business systems • Nationalistic concerns against foreign takeovers (political and media levels)
Post-acquisition: Failure in integration	• Poor organizational fit • Failure to address multiple stakeholder groups' concerns	• Clashes of organizational cultures compounded by clashes of national cultures • Nationalistic concerns against foreign takeovers (firm and employee levels)

A primary pre-acquisition challenge is due diligence, that is the assessment of the target firm's financial status, its resources and the fit between the target and the acquirer. Fundamentally, whether acquisitions add value boils down to how merged firms are organized. It concerns, first, strategic fit, which is about the effective matching of complementary strategic capabilities that allow to jointly achieve more, or achieve the same at lower costs.[40] In addition, but often not considered as carefully, it is crucial that the two firms have good organizational fit, which is the compatibility of cultures, systems and structures.[41] On paper, Daimler and Chrysler had great strategic fit in terms of complementary product lines and geographic scope, but there was very little organizational fit. American managers resented the dominance of German managers, and Germans disliked being paid two-thirds less than their Chrysler colleagues. These clashes led to an exodus of American managers from Chrysler – a common phenomenon in acquired firms.[42] The cultural clashes between the American and German units of DaimlerChrysler greatly contributed to the eventual failure.

Due diligence
The assessment of the target firm's financial status, resources and strategic fit.

Strategic fit
The effective matching of complementary strategic capabilities.

Organizational fit
The similarity in cultures, systems, and structures.

During the post-acquisition phase, the merging organization faces numerous integration challenges. The key challenge is to realize the synergies that motivated the merger in the first place, which involves the often conflicting objectives between the creation of new capabilities and exploitation of existing resources in the larger organization.[43] At the same time, firms need to address genuine concern of many different stakeholders, who fear job losses and diminished power, and who may engage in self-serving action to undermine the efforts of the new owners. Inappropriate management of these human factors often results in low morale and high staff turnover.[44]

In cross-border M&As, integration difficulties may be worse because clashes of organizational cultures are compounded by clashes of national cultures.[45] When Four Seasons acquired a hotel in Paris, the 'American' request that employees smile at customers was resisted by French employees and laughed at by the French media as 'la culture Mickey Mouse', which the Americans found offensive.[46] Such problems of cross-cultural management in post-acquisition integration are even more profound when entering culturally distant countries, such as US firms entering China (In Focus 14.3). Hence, to create value in cross-cultural M&A, capabilities in managing post-acquisition processes are particular important.

Rarity, imitability and organization

Although many firms undertake acquisitions, a much smaller number have mastered the art of post-acquisition integration.[47] The high failure rate of acquisitions in combination with strong track records of some firms, such as General Electric, in managing acquisitions, suggests that capabilities to manage acquisition are indeed quite rare. For example, GE Capital, a finance firm associated with General Electric, developed acquisition competences by conducting one acquisition after the other. Their integrated the process over four stages pre-acquisition, foundation building, rapid integration and assimilation, which includes drawing lessons from the next acquisition.[48]

These acquisition process-related capabilities are grounded in tacit knowledge in various units of GE capital, and thus they are *hard-to-imitate*. As another example, at Northrop, integrating acquired businesses is down to a 'science'. Each must conform to a carefully orchestrated plan listing nearly 400 items, from how to issue press releases to which accounting software to use. Unlike its bigger defence rivals such as Boeing and Raytheon, Northrop thus far has not stumbled with any acquisitions.

The capabilities to manage M&A processes are complex and specific to each organization. Hence they would be both hard to identify and imitate by outsiders, and they are embedded in the organization. They involve both manuals and 'to do lists', but also processes and assessments that draw on tacit knowledge of teams and individuals managing the post-acquisition integration.

LEARNING OBJECTIVE

6 Participate in two leading debates on acquisitions

DEBATES AND EXTENSIONS

This chapter has introduced a number of debates (such as the merits of acquisitions), and this section discusses two debates of concern to contemporary medium-sized European businesses (1) hidden champions and (2) globalfocusing.

Hidden champions

International business is often presented as primarily a matter of big MNEs competing for market share, especially in American textbooks. Smaller firm are often seen as fringe players in local or regional markets. With limited human and financial resources, a firm of, say, 1000 employees can hardly implement a global strategy – or can it?

In fact, across Europe, firms with 1000 or 5000 employees operate on the global stage in a specific, narrowly defined industry. Germany's infamous *Mittelstand* (medium size) firms have achieved market leadership in such global niche markets. They are often privately held, operate in business-to-business markets and are not widely known. Thus, they are often nicknamed hidden champions, a term coined by German professor turned consultant Herrman Simon.[49] They are leading in their selected niche markets world wide with competitive advantages grounded in highly specialized technological competences that are exploited worldwide.[50] The most famous examples of such firms have grown so fast that they are no longer able to hide: SAP, a developer of business software (see Chapter 4, Opening Case), Fresenius, a leader in dialysis care and Wuerth who sells fixing and assembly materials.

Hidden champions
Market leaders in niche markets keeping a low public profile.

Their (relative) smaller size typically leads them to conduct an aggregation strategy by focusing on elements of the value-chain that are shared around the world. Some combine this with arbitrage by offshoring production, while others, such as Kärcher (Closing Case) operate primarily out of their hub in Germany. Firms resembling the German hidden champions are also found in many other continental European countries with traditions in family businesses and commitment to manufacturing excellence. However, smaller size can be distinct disadvantage when competing head on with by big MNEs, as we discussed in Chapter 13.

Globalfocusing

Globalization has made global strategies more attractive. Yet, how can companies formerly diversified in a local or regional market develop a global strategy? The answer is, in part, that acquisitions and divestments, the sale of business units, are often closely related.[51] Many companies developed as an entrepreneurial company that initially experimented with a variety of different businesses ideas, before suceeding with a particular product or business model, and henceforth focusing all development on this line of business. Entrepreneurial teams often experiment with a variety of ideas and technologies before developing a core competence – which then becomes the focus on the company.

Divestment
The sale or closure of a business unit or asset.

IN FOCUS 14.2

The transformation of Nokia

Nokia is renown as a leading brand for mobile headsets, yet as recently as two decades ago, the mobile phone business generated merely 10 per cent of the revenues of what was then an industrial conglomerate in Finland. Nokia quite literally 'hit gold' with its mobile handset design and marketing and then focused its resources on exploiting this goldmine, selling its other business units along the way. The main restructuring occurred in one major wave in the early 1990s, and since then Nokia has grown its competences in mobile telephony and is exploiting these competences increasingly by developing and marketing other communications devices. While focusing its product scope, Nokia has established its brand globally, backed up by global operations.

The transformation of the company can be traced in its annual reports. In 1990, Nokia presented itself as:

> *'a European technology company, ... 84 per cent of turnover comes from EFTA and EC countries. The group is divided into six divisions, ... Main products are colour TVs and monitors, micro computers and terminals, mobile phones, digital telephone exchanges and telecommunication networks, cables and cable machinery as well as tyres and chemicals for forest industry.'*

In contrast, in 2009, the Nokia website introduced the company as:

> *'We make a wide range of mobile devices with services and software that enable people to experience music, navigation, video, television, imaging, games, business mobility and more. Developing and growing our offering of consumer Internet services, as well as our enterprise solutions and software, is a key area of focus. We also provide equipment, solutions and services for communications networks through Nokia Siemens Networks.'*

The synergies between the mobile phone handset business and the network business gradually diminished. Mobile phones increasingly are about design, fashion and user software, which brought Nokia into new consumer appliances such as satellite navigation. The network industry went through a concentration process, and had to face new competitors such Huawei of China. In 2006 Nokia created a joint venture with Siemens in which both firms merged their network business. The German –Finnish joint venture is led by Rajev Suri, an Indian who spend most of his professional career with Nokia in Asia.

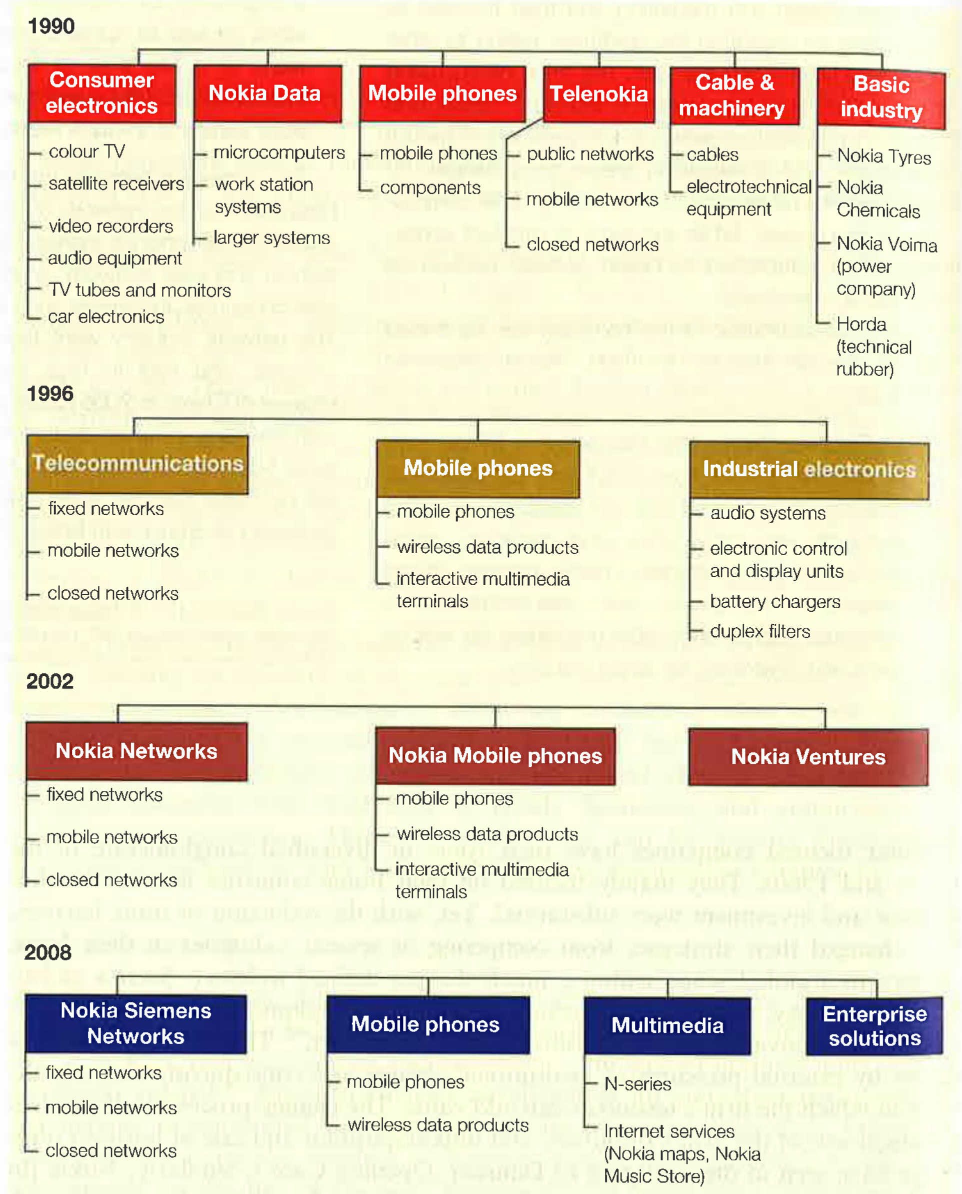
Source: Based on (1) K.E. Meyer, 2009, Globalfocusing: Corporate Strategies under Pressure, *SC*, 18: 195–207; (2) www.Nokia.com; (3) Nokiasiemensnetworks.com (accessed August 2009).

Other focused companies have their roots in diversified conglomerate of the 1950s and 1960s. They mainly focused on their home countries because barriers to trade and investment were substantial. Yet, with the reduction of trade barriers, they changed their strategies from competing in several industries in their home country to a global scope within a much sharper defined industry. Such a global-focusing strategy, that is the conversion of domestic conglomerate to a global niche player, has motivated many acquisitions and divestments.[52] This strategic change is driven by external pressures of institutional change and consequently shifts in the ways in which the firm's resources can add value. The change process itself involves a realignment of the firm's resources, and thus acquisition and sale of business units as we have seen in the evolution of Danisco (Opening Case). Similarly, Nokia (In Focus 14.2; Figure 14.3) has transformed itself in the 1990s from a Finnish conglomerate to the global mobile phone handset developer and marketer it is known for today.

Globalfocusing
A strategic shift from diversification to specialization which increasing the international profile.

The relative merits of alternative corporate growth paths, and hence the optimal scope in terms of product diversification and internationalization, are grounded in the transferability of the firm's resources across industries and countries. Some capabilities may be specific to a country, but may be profitably transferred to other industries within this country. For example, the in-depth knowledge of consumers and marketing practices may enable strategies of 'brand extension' to loosely related products. Other resources are more specific to an industry but may be exploited in this industry in other countries. For example, technological expertise for product development can be a foundation for international growth.

Figure 14.3 Nokia OY 1990–2008



Source: K.E. Meyer Klaus E. Meyer, 2009, 'Global focusing: corporate strategies under pressure' in *Strategic Change*, Vol.18 (5–6) pp,195–207. Copyright © John Wiley and Sons Ltd. Reproduced with permission.

IN FOCUS 14.3

Making M&As fly in China

The first wave of foreign direct investment (FDI) in China, in the 1980s, mostly took the form of joint ventures (JVs). A second wave followed in the 1990s in the form of wholly foreign-owned enterprises (WFOEs). Now a third wave of FDI – cross-board mergers and acquisitions (M&As) – is gaining strength.

Consider the forces driving this third wave. China has a massive appetite for FDI; it is one of the world's largest FDI recipients. Yet, M&As account for only 10 per cent to 15 per cent of FDI flowing into China, compared with approximately 70 per cent of FDI outside China that takes the form of M&As. One reason for this disparity is that, until China joined the World Trade Organization in 2001, national regulations often encouraged (or required) foreign entrants to form JVs or set up WFOEs, while explicitly discouraging M&As. But China has since gradually loosened the regulations that govern foreign takeovers of Chinese assets, especially state-owned enterprises (SOEs), and has made explicit moves to attract foreign M&As. In many industries, including financial services and manufacturing, constraints on M&As are just now being lifted. At the same time, Chinese firms are increasingly engaging in cross-border M&As of their own, as evidenced by their recent bids for Unocal, Maytag, and IBM's personal computer division. To the extent that the Chinese government supports the outbound M&As, it must in most cases clear the path for inbound M&As, according to international norms of reciprocity.

Given the environment, how should foreign companies proceed? In many ways, strategies for M&As in China overlap those for M&As elsewhere. But my recent research has uncovered some idiosyncrasies that are specific to acquisitions in China.

First, Chinese SOEs are rife with organizational slack. Government agencies have restructured some SOEs to reduce underutilized resources and to make the SOEs more attractive M&A targets for foreign firms. Although slack usually indicates inefficiency, in certain firms, some slack – such as unabsorbed cash flow in the form of depreciation funds reserve funds, and retained earnings – may indicate the potential for increased performance, actually enhancing targets' attractiveness.

Second, it is well known that many Chinese SOEs maintain three sets of books: one set that exaggerates performance, to brag to administrative superiors; one that underreports performance, for tax purposes; and one that is fairly accurate, for managers themselves. Acquisition targets are likely to show foreign negotiators the bragging books initially. As a result, foreign firms need to be aggressive in conducting due diligence to uncover an accurate picture of targets' assets and resources. This is particularly relevant when investigating slack.

Finally, most Western firms launching JVs and WFOEs in China have believed that ethnic Chinese managers – those from overseas Chinese economies, such as Hong Kong and Taiwan, who are well versed in the local language – were the best choice for running their operations in China. Meanwhile, they have presumed that Western managers would be less effective because of language and cultural barriers. But evidence from Mike Peng's own research and others' suggests the *opposite*: Using surveys, interviews and other tools, researchers are finding that ethnic Chinese managers hired by Western companies to run these businesses are, on average, *less* effective than their non-Chinese counterparts, as measured by the length of their tenures and attainment of performance goals. How could this be?

One reason appears to be that ethnic Chinese managers often struggle with an ambiguous managerial identity: Western corporate headquarters views them as 'us', and local Chinese employees also expect them to be 'us'. When these managers favour headquarters on issues where headquarters and locals conflict – such as whether Western employees and locals should receive equal compensation or whether chopsticks or forks should be used at company banquets – local employees may regard them as traitors of sorts. That corrodes employees' trust, ultimately undermining ethnic Chinese managers' performance. On the other hand, employees give Western managers the benefit of the doubt. They expect these managers to behave differently, to commit cultural

errors, and to show allegiance to the parent firm. This tolerance by local employees of Western managers' differences can enhance these managers' confidence and performance.

Of course, not every non-Chinese manager outperforms every ethnic Chinese manager. It is clear, however, that managerial effectiveness in China does not depend on one's ability to use chopsticks. This point is crucial as more M&As flow into China and more acquiring companies staff their target firms' management.

Source: Adapted from M.W. Peng, 2006, Making M&A fly in China, *Harvard Business Review*, March: 26–27.

IMPLICATIONS FOR PRACTICE

LEARNING OBJECTIVE

7 Draw implications for action

What determines the success and failure in global strategies? Our two core perspectives shed light on this 'big question'. The institution-based view argues that thorough understanding and skilful manipulation of the rules of the game governing acquisitions are often behind the fate of acquisitions. The resource-based view calls for the development of firm-specific capabilities to make a difference in enhancing acquisition performance.

Consequently, three implications for action emerge (Table 14.6). First, each firms needs a business model, a basic idea on how it is creating value from the resources at its disposal around the world. For many companies, this business model is the basis for achieving leadership in its chosen industry (or industries). For example, Danisco (Opening Case) is developing and producing food ingredients using natural ingredients from in a wide variety of locations, processing them, and delivering them into customers food processing factories worldwide. Kärcher (Closing Case) is manufacturing a great variety of customized cleaning machines exploiting its core technologies, and selling them around the world.

Second, when managing acquisitions, managers are advised not to overpay for targets and to focus on both strategic and organizational fit.[53] The strategic fit is about the contribution of the acquired firm – or a series of acquisitions and divestments – to the firms overall business model. Equally important is to manage the integration process after the deal is struck, by addressing the concerns of multiple stakeholders and try to keep the best talents. Be prepared to deal with roadblocks thrown out by people whose jobs and power may be jeopardized!

Third, managers need to understand and master the rules of the game – both formal and informal – governing acquisitions. Lenovo clearly understood and tapped into the Chinese government's support for home-grown multinationals. IBM likewise had a better understanding of the necessity for the new Lenovo to maintain

Table 14.6 Implications for action

- Appreciate and advance the global business model of the firm
- When managing acquisitions, do not overpay, focus on both strategic and organizational fit and thoroughly address integration concerns
- Understand and master the rules of the game governing alliances and acquisitions around the world

an American image by persuading Lenovo to set up its world headquarters in New York. This highly symbolic action made it easier to win approval from the US government in 2005. The upshot is that in addition to the economics of alliances and acquisitions, managers need to pay attention to the politics behind such high-stakes strategic moves.

Finally, when your boss or your business partner proudly announces the formation of a 'strategic alliance', your first question ought to be 'what exactly do you mean?' The term strategic alliances may be disguising a wide range of different transactions. It may be (1) a fancy term for a joint venture, (2) a partial acquisition that is the first step towards a full take-over (Chapter 13), (3) a divisional merger that secures the long-term viability of a struggling business unit, (4) an extensive operational collaboration that maintains both firms' independence or a range of other forms of working together. To assess the merits and risks of an alliance (including the impact on your own job), you need to know a bit more than the consultants' buzz words.

CHAPTER SUMMARY

1. Articulate the strategic advantages of globally operating firms:
   - Advantages include global scale advantages, global sourcing, global knowledge management, servicing of global customers and risk diversification.
2. Explain different business modes to exploit the advantages of a globally operating firm:
   - Aggregation strategies focus on the realization of synergies between operations in different locations.
   - Adaptation strategies aim to deliver locally adapted products in each market.
   - Arbitrage strategies exploit the differences in prices in different markets.
3. Explain why global firms engage in mergers and acquisitions, and alliances:
   - Acquisitions may be driven by expected synergies, by managerial hubriad or by self-interest of the individuals involved.
   - Alliances provide an alternative to a full acquisition, for example by merging business units, or collaborating on operations.
4. Apply the institution-based view to explain patterns of acquisitions:
   - Horizontal acquisitions may not be permitted if they result in a reduction of competition that is judged to be harmful to consumers.
   - Vertical acquisitions may not be permitted if they allow a dominant player to inhibit competition in an upstream or downstream industry.
   - Remedial measures include prohibition of the merger, required divestments or behavioural constraints.
5. Apply the resource-based view to explain when acquisitions are likely to succeed:
   - The impact of resources on acquisitions is illustrated by the VRIO framework.
6. Participate in two leading debates on global strategies:
   - They concern (1) how hidden champions can succeed, and (2) how globalfocusing allows conglomerate to become global specialists.
7. Draw implications for action:
   - Managers need to understand and master the rules of the game governing alliances and acquisitions around the world.
   - When managing acquisitions, the savvy manager should focus on both strategic and organizational fit.

KEY TERMS

AAA typology
Acquisition
Acquisition premium
Adaptation strategy
Aggregation strategy
Arbitrage strategy
Business unit JV
Centres of excellence
Divestment
Due diligence
Economies of scale
Global key accounts
Global sourcing
Global strategies
Globalfocusing
Hidden champions
Hubris
Merger
Operation collaboration
Organizational fit
Strategic alliances
Strategic fit
Synergies

CRITICAL DISCUSSION QUESTIONS

1. As an employee in a middle management role, you hear that your company has been acquired by a competitor based in a different country. What are your immediate and long-term concerns? What actions might you take?
2. As an investor, would you rather put your money in a domestic firm operating in multiple industries, or in a global company specialized in a single industry? What are the risks associated with either type of strategy?
3. As a CEO, you are trying to acquire a foreign firm. The size of your firm will double, and it will become the largest in your industry. On the one hand, you are excited about the opportunity to be a leading captain of industry and the associated power, prestige and income (you expect your salary, bonus and stock option to double next year). On the other hand, you have just read this chapter and are troubled by the fact that 70 per cent of M&As reportedly fail. How would you proceed?
4. During the courtship and negotiation stages of a merger, managers often emphasize equal partnerships and do not reveal (or try to hide) their true intentions. What are the ethical dilemmas here?

CLOSING CASE

Kärcher cleans up – worldwide

By Klaus Meyer and Bernd Venohr, Berlin School of Economics.

Cleanliness is often seen as a typical German trait. Alfred Kärcher GmbH & Co KG, a family-owned company based in Winnenden, a small town near Stuttgart, has built on this stereotype, and developed world market leadership for cleaning equipment and services. Kärcher became a global player in its industry segment selling more than 6.3 million cleaning machines annually in more than 190 countries, employing over 6800 people worldwide, and generating €1.3 billion in turnover in 2009.

Two ideas have guided Kärcher's strategy since the 1970s. First, the firm pursued a 'bottleneck-focused strategy' inspired by German management thinker Wolfgang Mewes. Essentially, this strategy suggests that the key to success is to concentrate on a specific 'burning challenge' (the bottleneck) for a well-defined customer group. Mewes advised companies to create maximum benefits for a target group by solving their most burning challenges. Based on its own resource profile the company should analyze which specific customer problem it can solve best, and find a customer segment that matches its resources. A supplier's attraction for its target group would raise sales, and correspondingly profits. Hence, Kärcher stopped product

How can a German Mittelstand firm like Kärcher become a world leader?

diversification and focused all resources on what it considered as Kärcher's core competence: developing and selling high-pressure cleaning equipment.

Second, Kärcher's product diversification was inspired by evolutionary biology. Charles Darwin recorded 14 different but closely related species of finches on the Galápagos Islands. The birds were of similar size but differ in the size and shape of their beaks, which are highly adapted to food sources available on different islands. This discovery led Darwin to the idea that different species could have developed from a small number of 'ancestral finches'. Kärcher thus developed specialized cleaning equipment, treating its high-pressure steam cleaner as the 'ancestral finch'. This allowed the company to solve previously untapped cleaning challenges, and led to its slogan 'Kärcher: cleaning is our business'. The company transformed itself from a manufacturer of high-pressure water cleaners into a 'think tank' that specializes in solving the cleaning challenges of an increasing array of customer groups.

Kärcher sells about 2500 products addressing cleaning needs of finely defined customer groups, included both businesses and private households. It is an innovation driven company that has about 400 engineers and technicians in the central R&D unit continuously developing new solutions to solve cleaning challenges. Growth comes primarily from new products because most products are quite durable, which limits replacement demand. Thus, 80 per cent of products sold are less than four years old. This rapid pace of innovation is supported by R&D investments of 4 per cent to 5 per cent of revenues.

A customer-driven innovation routine has become a core element of the organizational culture. Kärcher probably understands its customers' cleaning challenges better than the customers themselves. This know-how is based on intellectual property accumulated over 30 years, and continuously developed further. In 2007, the company held 342 patents and registered designs. Innovation is mostly incremental but may lead to major customer benefits: for instance a redesigned turbo/rotary nozzle increased the cleaning efficiency of building surfaces and roads by a factor of five.

Kärcher's international expansion initially focused on countries with a comparable standard of living, where cleaning needs were fairly similar. Thus, international market penetration targeted European countries from in 1974, then the USA in 1982 and Japan in 1987. By 2007, the company had 41 wholly-owned sales and service subsidiaries worldwide. Kärcher served most its key markets direct rather than via agents or other intermediaries, and by setting up greenfield sales operations. Only in the USA, Kärcher acquired several established companies to build its market position.

Many of Kärcher's products are under pressure from Asian low-cost producers, while the success has attracted larger competitors into this market. Kärcher therefore has to operate cost efficiently to remain price competitive, in addition to its innovative and customer-oriented differentiation. Kärcher still manufactures about half of its worldwide sales in Germany, while Germany accounts for only one fifth of its revenues. Four of its largest factories are in Germany, employing about 1250 people, with other plants located in Italy (3), USA (3), Mexico, Brazil and China.

How can Kärcher compete in view of German labour costs being among the highest in the world? Several factors contribute to the competitiveness of their German plants:

- The Kärcher product range is fairly complex, ranging from high volume consumer products to sophisticated small series of large professional cleaning equipment. All products are continuously improved, such that proximity between production and R&D, which is mostly in Germany, is crucial.
- In Kärcher's demand-led production system, all products are built to order. Factories are segmented into lines for different product types: within each line, employees can substitute for each other, which substantially enhances flexibility. Each factory specializes on one product group producing on a world scale to exploit economies of scale. This set-up enables Kärcher to deliver a complex product range with a high degree of flexibility and to adapt to seasonal variations in demand.
- Kärcher works with outside suppliers to develop new products and to share investments for new production equipment. Components are to a high degree outsourced, yet Kärcher decided against total outsourcing and is keeping most of the final assembly of its products in house. In particular, it retains some manufacturing capacity for its key technologies to strengthen its bargaining power vis-à-vis outside suppliers.

DISCUSSION QUESTIONS:

1. From an institution-based perspective, what influences may have influenced Kärcher's path of growth?
2. From a resource-based perspective, what motivated Kärcher's strategy of combining related diversification and internationalization?
3. How would you classify Kärcher in terms of the AAA-typology of global strategies? How did Kärcher manage to integrate these different aspects?

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T. Levitt, 1984, The globalization of markets, *HBR*, May–June: 92–102 – Classic article arguing for the merits of a global strategy.

K.E. Meyer, 2006, Globalfocusing: From domestic conglomerates to global specialists, *JMS*, 43: 1109–1144 – A study following acquisitions and divestments of two companies over time, and interpreting the process from an resource-based view by introducing the concept of globalfocusing.

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