

Mergers & Acquisitions

## Cross-border M&A Handle with care

By Caroline Firstbrook

Transnational deals now account for almost half of all M&A activity. But these transactions are not for the faint of heart and should be approached with particular care.

Despite the current tightening of credit and general economic uncertainty, one area of business activity has remained surprisingly robust: M&A. Although many players sat on the sidelines for the first half of 2008, global deal volume during the previous two years surpassed the record-breaking levels set in 2000. Moreover, the need for corporate growth and the availability of financing from new sources are likely to reignite the merger market boom and keep it going for the foreseeable future.

Several characteristics of the recent boom distinguish it from the previous one. The role of private equity has grown dramatically, doubling its share in global M&A deals—accounting for more than 31 percent of transactions in the current M&A wave

(2004–2007) compared with the prior M&A wave (1995–2000.) Other new investors, including corporations and sovereign wealth funds from emerging markets, have entered the M&A arena.

But the most significant trend has been the growth in the number of cross-border transactions, which now account for almost half of total M&A deal value.

What's behind the increase in transnational mergers? Many companies, faced with continued pressure to grow profits and with substantial cash on the balance sheet, see these deals as virtually mandatory; executives and deal makers surveyed by Accenture across the globe estimate that 20 percent of projected future growth will come from acquisitions.

**Fundamental problems can arise through a lack of understanding of the basic rules that govern how business is done in different cultures.**

However, in many industries—telecommunications and banking, for example—further national consolidation is constrained in more mature markets by antitrust regulations, forcing companies to look abroad for new targets. In addition, as competitors, suppliers and customers become more global in outlook, many companies are feeling the pressure to expand their geographic presence just to remain competitive.

Not surprisingly, then, the same Accenture survey revealed that the majority of respondents expect their next M&A deal to be a cross-border one. However, this research also shows that companies find these deals substantially more difficult than domestic acquisitions, and as a consequence, they are less confident in their ability to achieve projected revenue synergies and cost savings normally associated with these transactions.

Managing cultural differences, integrating across borders, and establishing a clear organizational structure and lines of responsibility are cited by survey respondents as particularly critical to the success of cross-border deals. Given expectations of continued growth, Accenture has identified three areas that can be especially problematic when undertaking a cross-border acquisition.

**The perils of distance: The case of the bungling headquarters spy**

As most people who have worked in large companies can attest, distance often creates significant barriers to effective teamwork. Without regular opportunities to meet face-to-face, misunderstandings easily arise. This can lead one group to conclude that their remote colleagues are incompetent or, worse, not acting in line with the organization's overall strategy. Add in language differences and culturally driven behavior and expectations, and the risk of misun-

derstandings only increases, making successful cross-border cooperation even more difficult.

Management can be its own worst enemy in this regard. For example, Accenture has frequently seen companies send a “nonessential” (translation: not very impressive) manager from headquarters to oversee operations at the new acquisition. There are several risks with this strategy.

First, such an individual typically lacks connections and credibility at headquarters and therefore has greatly restricted access to the critically important informal communication networks by which the company is really managed. As a result, the foreign operation is starved of key information about the wider strategic context in which the company operates—and, thus, essentially disengaged from the corporate parent.

A second, arguably greater risk is that the transplanted manager actively alienates local management, resulting in the departure of valuable talent. This was the case in one recent cross-border deal, where the manager imposed by the acquiring company was regarded by the local leadership team as “a bungling headquarters spy.” His unwelcome presence prompted the departure of almost the entire top management team in the first six months following the close of the deal.

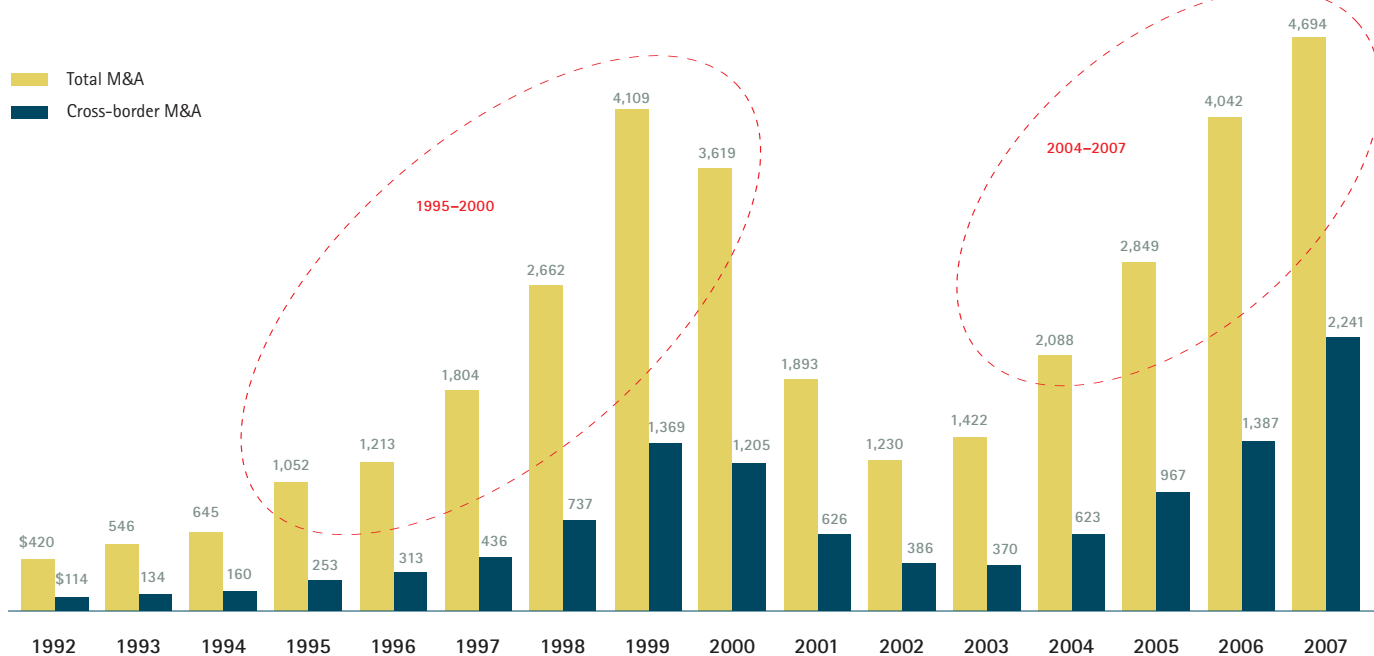
**Navigating national differences: “Don’t mention the war!”**

While all mergers require bridging the differences between corporate cultures, this exercise becomes even more daunting when you add in the effect of national cultural differences. In interviews, CEOs who have brought together companies in transnational deals consistently confirmed that the effort involved

## Peaks and valleys

The past 12 years have seen two distinct waves of M&A activity. The current peak is roughly equal to the previous one, after inflation is considered.

Total global and cross-border M&A transaction value (\$ billions)\*



\* All announced deals—completed and abandoned  
Source: Thomson One and Accenture analysis

in cultural integration was much greater and took much longer than they had expected.

Part of the problem stems from the strictures of “political correctness,” which discourage any overt references to national differences out of a fear of creating offense. Remember John Cleese’s harried English hotel owner in *Fawlty Towers* and his stern admonition to the staff when German guests were due to arrive at the seaside inn: “Don’t mention the war!”

This overly sensitive approach often ends up making people more uncomfortable than if they feel free to talk openly about their impressions of their new colleagues and their post-merger expectations, many of which are shaped by the local culture.

Fundamental problems can arise through a lack of understanding of the basic rules that govern how business is done in different cultures. For example, when working with Japanese colleagues, anyone who fails to understand the importance of maintaining the appearance of harmony and agreement (even when neither actually exists) risks creating serious discomfort among co-workers or causing offense at meetings with behavior that would be viewed as perfectly acceptable in a Western context.

Language is often a major barrier to the successful completion of a cross-border deal. With a few exceptions, it is seldom practical for an acquirer to impose its language on the acquired company. In many cases, enforcing the acquirer’s language stirs up resentment that

makes cooperation even more difficult. This is especially true when the two countries represented in the deal have a long and troubled history—such a language imposition winds up opening old wounds.

Often, the most practical solution is to adopt a neutral third language. When the Hungarian oil company MOL took over the former state-owned Slovak company Slovnaft, for example, language differences might have stoked national rivalries and thus threatened unity.

Instead, MOL recast the newly merged entity as an international company and required that all managers learn English; that way, neither company's home language would appear to be the favored one. MOL also went on a drive to recruit young employees with no ties to the pre-merger companies and the nationalist sentiments that went with them; these new hires' loyalties would instead be to the merged company.

A final area of concern is the reaction of national governments and consumers facing the loss of control of critical strategic assets or iconic brands. For example, when a foreign company was rumored to be considering the acquisition of Danone, the giant French company known for its yogurt, Prime Minister Dominique de Villepin declared that the government would come to "the defense of Danone's interests and the French future of Danone." The flap led to passage of a "strategic sectors" bill, dubbed "The Danone Law."

A similar outcry in the United States greeted Belgian brewing giant InBev's proposed acquisition of Anheuser-Busch, makers of revered American beer Budweiser. (The deal was nonetheless being finalized as this issue went to press.)

In the United Kingdom, the acquisition of Abbey National by Banco

Santander Central Hispano of Spain provoked an uproar from the British bank's small shareholders and the influential tabloid press. Fortunately, Santander had anticipated this reaction: Its carefully prepared response reassured its new UK customers that the acquisition would bring positive benefits and was not an attempt to impose strange foreign banking customs on them.

To avoid nasty or even deal-breaking surprises, would-be acquirers should research potential local reactions during the due diligence stage and carefully plan to ensure that they don't impede the new company's ability to operate effectively.

#### **Adapting business models: Preparing for cohabitation**

For companies making their first international acquisition, there is the further challenge of integrating a foreign business into an organization that has been optimized for operation in a single country. The volume of work required, for example, to accommodate multiple currencies, reporting requirements and local employment laws is often underestimated, leaving the acquirer poorly prepared to operate as an integrated whole.

Rigorous due diligence and a deal team that possesses deep knowledge of the local language, customs and legal requirements are essential. During the due diligence stage, close attention is needed to ensure that the apparent potential value of the target is being fully captured. In particular, the transfer of rights (including intellectual property) and assets, as well as access to favorable supplier contracts must be carefully considered.

For example, during the recent bidding contest for Canadian aluminium producer Alcan, it was essential for all parties to fully understand the conditions and risks

There are systematic differences in both values and behavior between countries that will color interactions between individuals of different backgrounds.

associated with the target company's supply agreements with the Quebec government, as continued access to cheap hydropower in the province underpins a substantial part of the company's value.

More broadly, the challenges of changing from a single, culturally integrated national organization operating in a familiar market in one time zone to managing a cross-border organization incorporating a new set of people, perspectives and issues can take many management teams by surprise. In many ways, it is not dissimilar to cohabiting with someone for the first time—there are quirks and behaviors to learn, new rules and constraints to understand, and a wide range of surprises in store—which may not all be pleasant. While the art of cross-border post-merger integration is still evolving, there are best practices that can be distilled from observing the most successful deal practitioners.

#### 1. Set clear expectations and invest in high-quality, two-way communication.

In a recent speech describing Telefónica's successful acquisition of UK-based mobile operator O2, Corporate Development Director Ángel Vilá Boix pointed out that the Spanish telco had spent the four years prior to the acquisition building a relationship with O2. Not only had this allowed Telefónica to execute an exclusive deal very quickly, it also laid the foundation for much more productive post-acquisition cooperation between the two companies' management teams.

Conversely, when cross-border deals go wrong, lack of clarity about goals and objectives, compounded by poor and deteriorating communications, is frequently a cause. In addition, careful attention is needed to ensure that remote companies fully understand the overall corporate

direction and have an opportunity to customize the strategy to local requirements.

For best results, companies need to bring together management teams across borders on a regular basis, whether through face-to-face meetings, management rotation or other methods. For example, critical factors in the successful integration of Abbey National into Banco Santander included a three-year plan with ambitious objectives, strong internal communications and the assignment of key Santander managers to work with Abbey on a day-to-day basis.

Some best practices Accenture has observed in this area include:

- Early integration of key leadership of the acquired company into the appropriate information and decision-making forums. This gives leaders access to the larger corporate context and ensures that local decision making is aligned with overall corporate direction.
- Selective use of headquarters management to support the leadership of acquired companies, rather than second-guessing or overruling them. These assignments should be treated as both sensitive and critically important for realizing the value of the acquisition and not as an opportunity to offload managers for whom no other obvious role is available.
- Headquarters' attention focused on critical decisions that will drive value in the acquisition, rather than micromanaging local activities or imposing rules and procedures that may not be appropriate.
- Investment in high-quality, two-way communications between the parent and the acquired company.

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# M&A in energy: New players, new rules

By Julie Adams

Getting smarter at cross-border M&A has never been more important for oil and gas companies.

The competitive landscape for deals in this sector has changed dramatically over the past three years. This means the ability to carry out cross-border transactions successfully is increasingly a competitive differentiator for all players in the industry but especially for international oil companies.

Success in the energy industry is generally measured by an oil company's ability to replace the reserves it extracts each year. A company adds to its reserve base through a combination of exploring and developing new reserves on its own and acquiring companies or assets via mergers and acquisitions.

The focus on reserve replacement means that upstream deals—involving exploration and production—tend to drive both the number and value of M&A transactions in the sector. The total value of upstream deals in 2007, according to industry analyst John S. Herold, was about \$154 billion, a slight decline from 2006. The number of global asset transactions continues to increase, however, and totaled \$89 billion in 2007, up nearly 40 percent from 2006, reflecting the difficulty in the industry (as in others) of acquiring foreign corporations.

A bellwether was the unsuccessful \$18.5 billion bid for US oil company Unocal by the state-owned China National Offshore Oil Corp. in 2005. In the wake of this failed bid, national oil companies, particularly from China, switched their focus to less regulated regions like West Africa and the Caspian Sea area.

Overnight, asset deals became the priority, state-owned companies became far more global in their outlook, and M&A in the sector became more competitive.

The scramble for assets is also being driven by the fact that the so-called easy-to-access oil and gas reserves are running out. Because national oil companies control access to reserves in countries where the majority of the world's oil and gas reserves are located, tapping these reserves by the international oil companies has become more challenging; this has forced them into more high-cost and unconventional plays like deepwater and oil sands. Moreover, the high price of oil is boosting the state companies' confidence as well as providing them with more cash to make deals.

Another characteristic of today's energy M&A landscape is the role of sovereign wealth funds. There are about 40 of these institutions around the world, and they are growing rapidly as trading balances flow into countries with extensive natural resources. Earlier this year, China's State Administration of Foreign Exchange acquired a 1.6 percent stake, reportedly worth more than \$2.8 billion, in the French

oil company Total and spent \$2 billion for a roughly 1 percent interest in the UK oil company BP.

Meanwhile, national oil companies from emerging economies have been increasingly active. According to their own data, both Brazil's Petrobras and China National Petroleum Corporation are building up impressive asset portfolios abroad. Petrobras is a major player in US Gulf of Mexico deepwater exploration; the company is planning to spend \$15 billion on international projects between 2008 and 2012, of which nearly \$5 billion will be invested in the United States. China's CNPC boasts exploration and production assets in 27 countries spanning four continents.

As state-owned companies emerge as the main deal makers in the energy sector, the international oil majors need to learn how to make successful deals with them. And for good reason: According to John S. Herold data, between 2005 and mid-2007, national companies completed 62 percent more deals than the majors, mostly in their own or other emerging economies.

In general, most state companies have ambitions both to internationalize and expand capabilities along the oil and gas value chain. But they are not necessarily looking to the majors to help them do this. In all the oil sector deals where a national company was a purchaser, only 8 percent were done with international companies; the majority were with other state companies, governments or midsize companies. Where state companies did partner with the majors, the deals were usually based on an already existing relationship, or a result of the geographic location of the assets for sale.

International oil companies now operate in a market where they have to do business and compete against a varied and more sophisticated group of globally minded state-owned companies, and where the rising costs and complexity of projects mean delays in securing approvals and lengthening deal time frames. They must adapt their M&A strategies accordingly.

To access key assets in those areas controlled by national companies, the majors are paying much more attention to the different priorities of the state companies, broadening the scope of the deals they are offering and showing a willingness to play across the value chain. This involves more integrated deals, with the international companies blending their exploration and production, gas and power, downstream and chemicals businesses as necessary to build more appealing commercial offers.

A good example is the involvement of the oil majors in Qatar, where a combination of huge scale, technical challenges and market complexity has created ideal conditions for international company participation in key gas projects in partnership with the emirate's national oil company.

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This provides transparent visibility of performance, early warning of potential problems or changes in direction, and clear roles and responsibilities on both sides for maintaining these links.

## 2. Acknowledge cultural differences but simultaneously create a common corporate culture with a single goal: achieving high performance.

The rules of polite society tell us that it is rude to refer to national stereotypes, or to base expectations of behavior or performance on cultural background. In fact, however, there are systematic differences in both values and behavior between countries that will color interactions between individuals of different backgrounds. Understanding these so-called stereotypes can be extremely useful in avoiding misunderstandings.

There are many useful published sources that can help executives anticipate and understand the behaviors they will encounter within a newly acquired company. Unsurprisingly, these usually confirm the accuracy of many widely held assumptions about cultural differences. For example, generally if not categorically speaking:

- Germans dislike uncertainty.
- French are inclined to be skeptical and self-critical.
- Japanese place a high importance on correct form and ceremony.
- Swedes prefer decision making based on consensus.
- British have a high tolerance for ambiguity and use humor in ways that foreigners often find puzzling.
- Americans are less formal than Europeans.

Awareness of, and sympathy for, national differences played a valuable role in Abbey National's smooth integration into Banco Santander.

Understanding that the English are much more formal than Spaniards about scheduling appointments was important in defusing a potential source of frustration among Santander's senior management. For their part, the English learned that their Spanish counterparts place great importance on the extended sit-down lunch as a source of informal communications and networking.

One advantage of openly acknowledging cultural differences is that it sets the stage for a broader examination of the larger post-merger company culture, and creates an opportunity for the two entities to work toward a single shared culture that is more supportive of high performance. Conversely, the failure to acknowledge and adopt superior practices of the acquired company can result in lost value opportunities, usually accompanied by the departure of key individuals.

One pharmaceutical merger, for example, combined two companies with very different attitudes about the organization of international teams. The smaller, acquired company favored a more informal approach, while the larger, acquiring company relied more on formal structures and procedures. Rather than examining these differences and evaluating their relative merits, the large company's approach dominated by default, resulting in the loss of key skills and management, and, ultimately, the closure of several international sites.

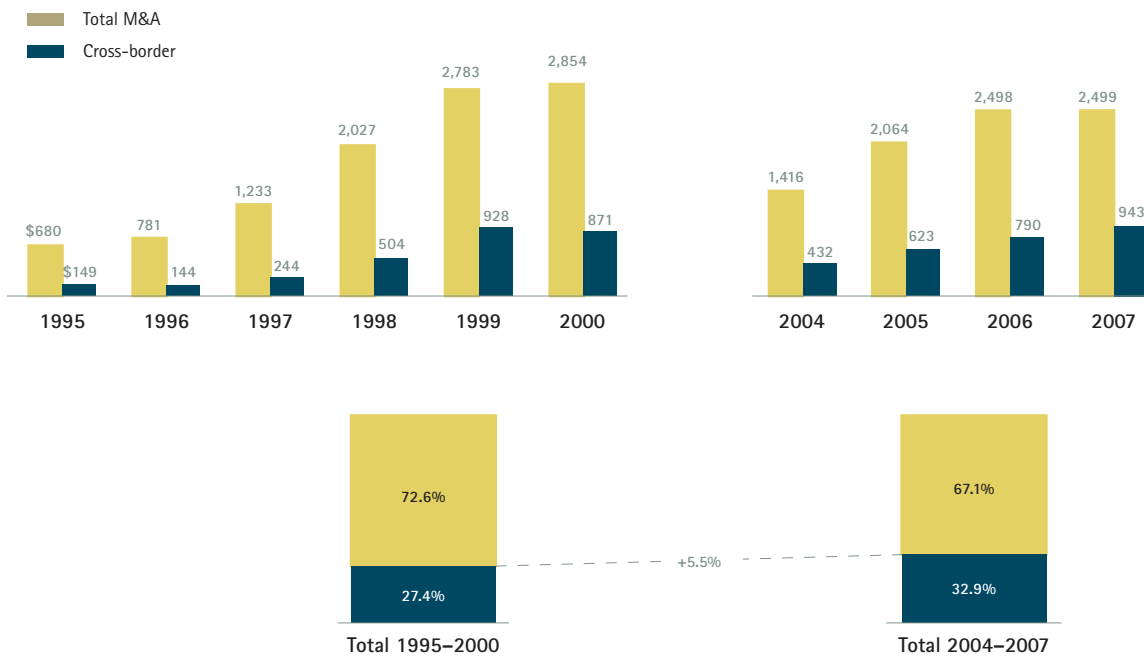
Some best practices in this area include:

- Workshops to raise awareness of and sensitivity to cultural differences. These should cover both national differences and those arising from different company cultures.
- Use of tools such as the Accenture Culture Value Analysis to objectively

## High and higher

Cross-border deals are up markedly in the recent wave, jumping from 27 percent to 33 percent of total deal value. In 2007, cross-border deals reached a new high: 38 percent of total deals.

Completed global M&A transaction value for deals above \$250 million (\$ billions)



Source: Thomson One and Accenture analysis

assess both organizational cultures, from the macro level down to individual functions and departments. Such tools can be used to establish a baseline against which change can be measured and to identify potential areas where gaps are likely to create integration problems.

- A clear description of the desired post-merger shared culture, one that combines the strengths of both organizations.
- Formal programs for cultural change sponsored and driven from the most senior levels of the organization.

### 3. Move to a cross-border operating model

The recent surge in cross-border mergers is part of a broader set of trends that reflect how companies are adjusting their strategies to compete in a world in which customers and suppliers are increasingly global. The best international competitors are simultaneously leveraging the benefits of global scale and configuring activities to ensure a highly tailored response to local customer needs. Cross-border deals are often the first step in establishing an international footprint.

For many companies embarking on a cross-border acquisition for the

first time, the temptation is to make as few changes as possible in the structure and management processes of the newly acquired company, and to look for the most straightforward way of connecting them to an existing operating model. While this is often a safe near-term strategy, over time the failure to exploit the benefits of scale can add up to significant lost profit opportunities.

More sophisticated acquirers will move to realize the obvious cross-border synergies, such as leveraging purchasing scale or moving to shared back-office services. At the same time, the continued duplication of management structures, the inefficient distribution of assets and the dispersion of critical skills across multiple geographies often

remain as unexploited opportunities for profit improvement.

The most sophisticated multinationals, such as Unilever and Procter & Gamble, are now moving to implement an operating model that allows them to be simultaneously “super global” and “super local.” With this approach, they can exploit scale, leverage scarce skills for improved customer results and tailor their service to the needs of both mature Western markets and the more fragmented developing world.

This model is probably not appropriate for companies that have only recently expanded beyond their national boundaries. But keeping this approach in mind while looking ahead may lead to opportunities to leapfrog the interim stages of operating model development.

The changes behind the recent boom in cross-border mergers have become permanent features of the global M&A landscape. Companies that develop superior skills in selecting, evaluating and integrating cross-border acquisitions will benefit from faster growth and higher profitability. Those that struggle are more likely to become acquisition targets themselves.

While each merger is unique, there are companies that do these deals particularly well. The attributes and skills they share make up the best practices that will drive this market for years to come.

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