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Bachelor thesis

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Due diligence, a comprehensive tool for a positive cross-border M&A

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Abstract

Due to upward globalization, cross-border M&A has become an important and ascending strategy for firms intending to expand abroad. However, empirical studies show that several M&A transactions have failed in the past few years, which could be avoid through an improved form of due diligence. Therefore, it is necessary to have an understanding about the phenomenon of international M&A as well as the due diligence process and its improved form, the integrated due diligence.

Through the due diligence process, chances and challenges of the transaction should be identified and analysed, considering also firm and country-specific differences and commonalities between the acquirer and the target company. Doing so will generate a foundation for a well-planed integration management, resulting in a positive cross-border M&A.

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III. List of abbreviations

ABC	ABC analysis is an inventory categorization technique
BRICS	Acronym for an association of five major emerging national economies: Brazil, Russia, India, China and South Africa
DCF	Discounted Cash Flow analysis
KPI	Key Performance Indicator
KPMG	Auditing and advisory firm, sited in Amstelveen, Netherlands. Forming members: Klynveld, Peat, Marwick, Goerdeler
M&A	Mergers and Acquisitions
PMI	Post-Merger Integration
SWOT	SWOT analysis is an acronym for strengths, weaknesses, opportunities, and threats
UNCTAD	United Nations Conference on Trade and Development, sited in Geneva, Switzerland
WACC	Weighted Average Cost of Capital

1 Introduction

1.1 Research problem

In the era of increasing global economic networking, cross-border mergers and acquisitions (in the following "M&A") have become an important factor for the growth and success of enterprises. Such activities provide the most rapid means of establishing an international presence in specific markets, as a mode of global expansion (Hitt & Pisano, 2003, p. 133). Cross-border M&A can be considered as an opportunity for firms wishing to diversify their activities geographically, gain access to new resources, know-how and innovations. Moreover, it is easier to enter a new market with existing customers, relationships and knowledge about that market.

Studies, however, show that a large number of cross-border M&A fails, because they face numerous challenges. These include the difficulty of evaluating acquisition targets, different strategic orientation, cultural and institutional differences, the liabilities of foreignness among others (Ibid), as well as challenges related to the specific country, for instance, political and legal challenges, differences in the economic situation and market structure (Wirtz, 2006, p. 137).

Additionally, M&A transactions have a complex process. From the pre-merger phase, the negotiations to the post-merger phase, each deal is different and will face different challenges. Nevertheless, there are always several variables surrounding the transactions that can be analysed and thus, improve the integration outcome. So, because of the importance and complexity of M&A, there is a need to analyse more cautiously and understand the chances and challenges provided by these activities.

This mentioned comprehensive analysis is normally called due diligence. Most firms already include a due diligence phase in their M&A transaction. However, there has been still a high rate of failure between international M&As. Therefore, this thesis assumes that a new approach of due diligence, the so-called integrated due diligence, should be applied in order to increase positive outcomes. It helps to uncover opportunities and risks; to identify differences and commonalities, synergies and integration potentials between the acquirer and the target company; and lastly to prepare a successful integration management. If due diligence is the investigation and gathering of information, integration is the implementation of what

has been discovered during the due diligence phase. Therefore, a forward-looking due diligence should be a basis for a positive post-merger integration.

Thus, the aim of this thesis is to give a general understanding about the phenomenon of cross-border M&A and the process of due diligence, and to examine country and firm specific differences and commonalities of cross-border M&A in order to be able to meet the challenges, propose measurements how to best overcome them or eventually turn them into possibilities. Ultimately, these analyses should be used to give practical recommendations for the successful implementation of M&A, as well as how to make cross-border M&A work.

This bachelor thesis is based on the assumption that companies planning a cross-border M&A need to consider the chances and challenges of an international deal. Based on the understanding that M&A is a complex process, a comprehensive analysis, in form of an integrated due diligence, of country and firm-specific differences and commonalities is required for a positive post-merger integration. This also enables the stakeholders to overcome challenges and eventually turn them into chances.

1.2 Course of investigation

A secondary qualitative research method, literature based, will be applied in order to develop an understanding of cross-borders M&A transactions and due diligence, and to solve the research problem. Most of literature used in this paper was scientific based except for a few grey literatures due to the fact that this new approach of due diligence has not been widely discussed yet and also to be able to give more real examples.

Based upon the research problem, this paper started with a short introduction of the subject, explaining the research problem, the research methodology and the course of investigation. In chapter 2, a general understanding about the phenomenon of M&A will be given, considering its relevant definitions and types. Moreover, specific particularities of cross-border M&A will be introduced as well as the development over time and its actual relevance. In addition, its complex transaction process will be presented.

Subsequently, in chapter 3, the concept of due diligence will be addressed as a way of meeting the chances and challenges of an international M&A. Two forms of due diligence will be presented, the traditional and integrated one. Afterwards, cross-border opportunities and challenges will be analysed, including firm and country-specific challenges. Then, a real example of a failed merger will be examined.

Thereafter, in chapter 4, a recommendation for a positive cross-border M&A will be presented in order to meet the chances and challenges through the integrated due diligence process. In the conclusion, chapter 5, a summary of the findings will be given.

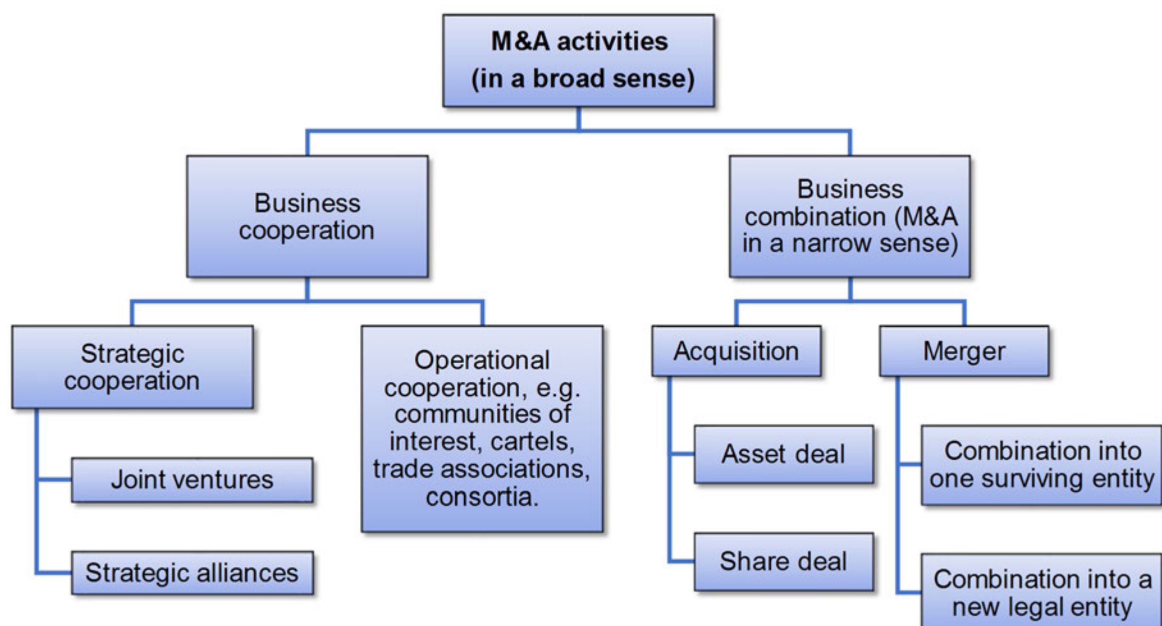
2 The phenomenon of cross-border M&A

2.1 Relevant definitions and types

M&A is a generic term for national and international mergers and acquisitions, however a common definition for M&A in the literature has not been established yet.

There are numerous terms used in the Anglo-Saxon and German literature relating to M&A, for instance, terms like takeover, transaction, consolidation, concentrations, fusion, amalgamation, business combination, tender offer, and sell-off. All these terminologies are generally subsumed under the generic term M&A. In the United States, the term M&A covers a wide range of corporate activities beyond the traditional means of strategic expansion like business combination and strategic cooperation. Copeland and Weston (1988, cited in Wübben, 2007, p. 5) asserted that the "traditional subject of M&A has been expanded to include takeovers and related issues of corporate restructuring, corporate control, and changes in the ownership structure of firms". The figure bellow shows the many areas of M&A that can be derived from this broad definition.

Figure 1: Forms of M&A



Source: own drawing based on Wirtz, 2012, p.13

Because of the numerous different definitions in the literature, it seems relevant to enter into the basic forms of M&As. Under economic and legal aspects, a distinction is made between business cooperation and business combination as outlined in

figure 1. In the case of business cooperation, the companies cooperate voluntarily and remain legally independent, and also economically independent in the areas not affected by the cooperation. In the case of business combination in a narrow sense, the companies lose their economic and, optionally, their legal independence (Wirtz, 2012, p. 13). Gomes, Weber, Brown, & Tarba (2011, pp. 7, 8) also stated that business cooperation is simply an agreement between two or more parties that jointly manage assets in order to achieve common strategic goals, for a temporary period, while maintaining their own corporate identities, i.e. there is only a low level of control between the companies. By contrast, business combination involves the management of all the assets of the participating firms under common ownership and high level of control.

Within this paper the definition of the term M&A follows the narrow interpretation, i.e. M&A as a business combination, considering all transactions in which the businesses of companies are combined through the purchase of a majority of assets or shares, or through a merger. So, here the term M&A is limited to strategically motivated business combinations, that means, transactions that result in the transfer of ownership as well as management and control rights from one firm (the target) to another (the buyer) (Wübben, 2007, p. 6). Thus, in a business combination, at least one of the companies involved in the transaction renders leastwise economic independence. Under economic and legal criteria, two forms are to be distinguished: the acquisition and the merger (Wirtz, 2012, pp. 16, 17).

Under acquisition is understood the purchase of a company or business units. A company can be acquired through an asset deal or a share deal or a combination of both. The asset deal represents a takeover of individual economic assets and liabilities of the acquired company, which will appear in the balance sheet of the purchaser. In a share deal, company shares are transferred. Moreover, it can be assumed that in an acquisition, the economic independence is partly or completely restricted (Lucks & Meckl, 2015, pp. 5, 6).

The merger or fusion of companies represents the second form of a business combination. In this case, two companies will be economically and legally combined, that means, after the fusion exists only one legal entity (Wirtz, 2012, pp. 16, 17). Therefore, a merger is the union of two or more, previously, legally and economically independent companies, whereby at least one participating company loses its legal

independence (Lucks, & Meckl, 2015, p. 5). In mergers, two forms are distinguished. The first one is characterized by the fact that a company, which has hitherto been independent, transfers all its assets to the partner and is integrated into it, while losing its previous legal and economic independence. On the other hand, in the case of the classic merger, a new organizational unit is created by the partners so that the individual companies are extinguished after transferring the assets to the new unit (Ibid).

In addition to that, two types of M&A transactions can be distinguished: hostile and friendly takeovers. As the two terms already suggest, not all acquisitions are taken in agreement, but are rather forced by the buyer. Since the decision to sell a company lies solely with the shareholders and not with the management of the company, there may be conflicts between the management and the owners about a takeover offer. If a company submits a public takeover offer to another company, the management of the target company may recommend its takeover to its shareholders or consider the offer as unfriendly or hostile. However, the hostile takeover form is rather the exception. Prominent example is the purchase of Mannesmann by Vodafone in 2000 with a transaction volume of 186 billion US dollars (Müller-Stewens, 2016, pp. 11, 12). The distinction between these two forms is particularly relevant in the evaluation of opportunities and risks, since the transaction process of the two forms of takeover differs. Particularly, in the case of unfriendly takeovers, the risks are often significantly greater than in the case of friendly takeovers, since due diligence is not, or only to a limited extent possible due to information asymmetry or no collaboration of the target company.

Furthermore, there is a wide range of forms and divisions for M&A deals. The differentiation of the transactions according to the strategic orientation is important for the economic understanding of M&As.

Figure 2: Categories of M&A based on strategic direction

		Products / Technology	
		Identical / similar	**New**
Market	**Target is supplier / customer**	Vertical	Vertical
	Identical / similar	Horizontal	Market-concentric
	New	Technology-concentric	Conglomerate

Source: own drawing based on Wübben, 2007, p. 8

Four major forms of M&A activities can be identified according to its development direction, as demonstrated in figure 2, horizontal, vertical, conglomerate and concentric (Wübben, 2007, p. 8).

A horizontal transaction happens between competing companies producing similar goods or services in the same industry and approximately the same customers and suppliers. This kind of transaction is seen as a mean of making cost savings through the exploitation of economies of scale and scope. Additionally, horizontal M&A leads to the elimination of a competitor, to an increase in the market share of the acquiring firm and to a rise in the degree of concentration of the industry (Gomes et al., 2011, p. 10).

Vertical transactions occur between companies operating in the successive stages of a continuous production process. Such transactions normally aim at reducing uncertainty and transaction costs in forward and backward linkages of the production chain, usually in client-supplier or buyer-seller relationships (Wübben, 2007, p. 9).

A conglomerate happens between companies producing unrelated goods or services and operating, therefore, in different industries. These transactions seek to benefit from economies of scope, portfolio diversification and so, to diversify risk (Gomes et al., 2011, p. 12).

Concentric M&A takes place by acquiring a target firm, that operates in the same market as the acquirer, but with a product or technology portfolio that is unrelated to that of the acquirer (market concentric) or vice versa (technology concentric) (Wübben, 2007, p. 9).

Nevertheless, it is important to note that in practice, M&A activities often contain a mixture of the different categories.

2.2 Major specificities of cross-border deals

A cross-border M&A is simply a transaction involving at least two companies from two different nations, i.e. an acquirer firm and a target firm whose headquarters are located in different home countries (Reddy, 2015, p. 4).

In general, cross-border M&A and its due diligence process remain under-explored compared to domestic deals. Preceding research focusses on the purposes of a cross-border transaction claiming that M&A is an important instrument of market entry to achieve international rapid expansion and access to new resources (Sacek, 2015, pp. 20–21).

Cross-border M&A is driven by the same strategic considerations that other forms of entering a foreign geographic market, for example, greenfield investments, strategic alliances and joint ventures. The purpose is to exploit the company´s competitive advantages or/and to explore necessary strategic resources and knowledge, such as technical and managerial know-how. This international use of resources and capabilities generates more synergy gains than a domestic transaction. In addition, international M&A can be encouraged by the desire of the acquirer to diversify internationally. A cross-border deal is also a possibility to achieve growth if a company had already reached its demand capacity in its national market. Furthermore, an acquirer may be able to raise capital in a low-cost location or to arbitrage some restrictions, such as tax codes, just by having operations in other countries. Besides that, he may also benefit from favourable changes in the currency (Wübben, 2007, pp. 27, 28).

The increasing globalization has intensified the opportunities and pressures to engage in international M&As. Nevertheless, there are unique challenges associated with an international deal (Simmons, 2008, p. 4). For instance, the negotiation costs are significantly higher than for domestic deals due to international setting and other country differences. Concerning value creation, a survey by KPMG reported that only 17% of cross-border M&A created shareholder value, while 53% destroyed it. Thus, a country's governance system, institutional framework, legal environment, trust and relationship, and culture play a key role in cross-border transaction (Reddy, 2015, pp. 4, 5).

So, it's essential to note that international transactions are much more complex than domestic ones. Therefore, there is a necessity to analyse business conditions abroad and find the gaps between own domestic conditions and foreign ones. This can be a challenging process, which should not be underestimated. In the last century, the M&A market has been expanding globally (Ourvoie, 2016, p. 4). But despite the geographical growth, there are still significant differences between

countries. As written by Ourvoie (2016, p. 7), “Deal makers must pay attention to these differences, and not assume that what they see in their home country will be replicated in other contexts”. The author means differences in national laws, economic performance, institutional quality, political stability, corruption, administration, among others. This principle of caution, based on the due diligence process, will reduce considerably the causes of failure in a cross-border deal.

So, as already written, cross-border deals have an increased level of complexity if compared with domestic deals, mainly because of the numerous parameters that must be taken into account before a deal is closed. International transactions should certainly cover such different areas as economy, regulations, finance, markets, competition, assets, people, technologies, and so on. The truth is, every deal will be different. “How local economies perform, how they rely on infrastructure, how they optimize raw materials, how employees and clients consider the concept of proper social relations, work time versus leisure, duty, reporting, loyalty, and how all these apparently universal concepts are modelled is in fact very different from one country to the next” (Ibid, p. 18). Knowing all these aspects is a prerequisite to guarantee the transaction has reliable expectations and a good leverage of potential synergies. International deals are often subject to geopolitical changes, affecting the economy, access to resources, foreign investment policies, or the creation of new markets, which may encourage or burden their development. In response, firms tend to improve the due diligence process: assessment of country and firm specific aspects (Ibid, pp. 22, 23)

Besides, internationalization and cross-border transactions need a strong decision-making process linking strategy, deal execution, and post-merger integration. Because of the complexity of cross-border deals, the acquirer should be prepared and develop a precise view of the business context, which is part of the strategic assessment of the due diligence process (Ibid, pp. 23, 24).

2.3 Development over time

The business press report almost every day a new spectacular M&A, mostly involving companies from different countries. The WhatsApp acquisition by facebook for approximately 22 billion USD or the purchase of the customer care division of Merk & co. by Bayer AG for approximately USD 14.2 billion, are just two

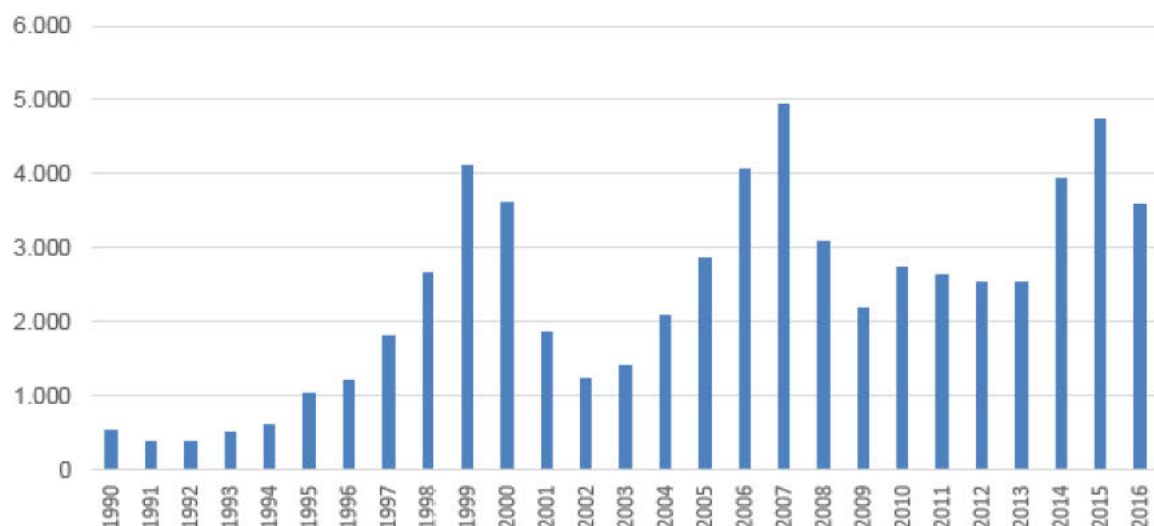
examples of mega deals in 2014, which show impressively the relevance of the phenomenon of M&A for the development of whole branches at the international level. Taking a look at the statistics, especially in a historical perspective, it becomes clear that M&As have experienced for a long time a marked upturn in popularity of managers and owners, despite considerable uncertainties in the business environment (Lucks & Meckl, 2015, p. 1).

The area of M&A is extremely old, and was originated at the end of 19th century in the western world. An important characteristic of the M&A market is that it is a cyclical one. Historical research, mostly focusing in the US market, has shown the existence of cycles or waves in M&A activity since the late 1890´s. Some authors argue that merger waves happen when firms react to "shocks" in their environment, for instance, the emergence of new technologies, distribution channels or substitute products; from deregulation; or a rise in the commodity prices (See Petmezas, 2009). Others argue that merger waves are based on the misevaluation idea and suggest that managers use overvalued stock to buy the assets of lower-valued firms. As written by DePamphilis (2012, p. 13), several studies confirm that long-term fluctuations in market valuations and the number of takeovers are positively correlated (See also Dong, et al., 2006).

So, six merger waves were found until now. The first wave, called the Horizontal Consolidation, occurred during 1897 to 1904 and aimed at increasing concentration in primary metals, transportation, and mining. The second merger wave led to increase vertical integration and oligopolies during 1916 to 1929. The Conglomerate Era, the third merger wave (1965-1969) aimed at creating large conglomerates and improving functional optimization. The fourth merger wave (1981-1989) was characterized by the breakup of many major conglomerates and a proliferation of the hostile takeover and leveraged buyouts. The main causes were the technological progress in biochemistry and electronics, along with the creation of new financial instruments and markets. The fifth merger wave (1992-2000) arose the new term "cross-border M&A" as a result of the economic boom, globalization, continued deregulations, information and technology revolution, reduction in trade barriers and stock markets development. Finally, the sixth merger wave (2003-2007) is characterized by lower asset valuations, the proliferation of complex securities and the global financial crisis of 2007 (See DePamphilis, 2012, pp. 14, 15; Reddy, 2015, pp. 6, 7; and Ourvoie, 2016, pp. 12, 13).

As seen in the chapter before, cross-border M&As have long been an important strategy to expand abroad. As a result of technological developments and globalization, international deals sharply increased over the last three decades. They continually surged in the 1990s reaching a pick in 1999 with the booming stock markets and the larger degree of financial liberalization worldwide (Coeurdacier, et al., 2009, p. 7). As reported by the UNCTAD (2000), the value of cross-border deals accounted for 26% of total acquisitions during 1986-2000 and approximately 80% of foreign direct investment by developed economies took place in the form of M&A. During this period, European firms engaged in several mega M&As, such as the cross-border takeover of Mannesmann (Germany) by Vodafone (UK) mentioned before in the telecommunication sector (Brakman, et al., 2006, p. 9); Daimler/Chrysler in the automotive industry, Deutsche Bank/Bankers Trust in financial services industry (Reddy, 2015, p. 7). After 2001 the M&A activities declined sharply and rebounded again with new developments in the world economy after 2003, as can be observed in the figure bellow.

Figure 3: Volume of global M&A deals (in billions of US dollar)



Source: own drawing based on Statista 2017

The number of international acquisitions has increased from 23% of total volume in 1998 to 45% in 2007, when M&A transactions reached a record level worldwide with a volume of 4.960 billion dollars, as shown in figure 3 (Statista 2017). Mostly because of the low interest rates, rising equity markets, technological changes, global competition, and industry consolidation.

Furthermore, due to the financial crisis and lower asset prices, multinationals from emerging markets have been diversifying their products and services to developed economies through M&A. For example, China-based Lenovo acquired the computer division from US based IBM and the same company bought Motorola from the US based Google's portfolio business (Reddy, 2015, p. 8).

Already in 2008, the overall volume of transactions went down due to the turbulence in the global credit market and recession of most of the world´s economies caused by the financial crisis (DePamphilis, 2012, p. 16). However, as can be seen in figure 3, the volume of M&A deals has increased again in the past few years reaching 4.760 billion dollars in 2015 (Statista, 2017). Besides, cross-border M&A has increased its importance on the market, accounting for 36% of the total volume in 2016 versus 31% in 2015. "A surge in China outbound deal volumes contributed to overall cross-border M&A growth, as Chinese companies sought attractive opportunities abroad" (J.P. Morgan's M&A team, 2017, p. 2). JP Morgan´s team (2017, p. 4) also expects that an active cross-border M&A market will continue to grow, as companies face pressure to complement modest organic growth, looking for new regions for exposure to different economic, market and consumer dynamic. M&A activities will also be encouraged by low cost of funding and positive acquirer share price reactions. Additionally, the uncertainty in the UK market caused by the Brexit is likely to bring M&A opportunities from UK acquirers entering new markets to seek opportunities for growth and expansion (Ibid, p. 12).

Given the frequency and volume of deals which such activities occur, it is vital for business people to have a basic understanding about M&A and how it takes place. Moreover, for managers who intend to apply this kind of business strategy, a lack of understanding can mean the failure of such transactions. As observed, cross-border M&A has been increasing a lot in the past few decades. However there has been an extent of uncompleted deals in the world M&A market. Based on the Thomson Financial M&A database for the period 1982-2009, 210.183 deals found to be unsuccessful (460.710 deals completed) out of 670.893 acquisition events (Zhang et al., 2011, p. 226). As with other success-relevant factors, an efficient management of M&A transactions and a deep analysis (the due diligence) of the whole deal must ensure that this strategic option will lead to an improvement in the competitive position of both companies, to a total increase in value and a positive integration. For this purpose, the M&A transactions phases should be analysed.

2.4 Transaction process

In a survey, factors of failure and success for German investors in India were identified. The lack of adequate preparation and planning was found out to be the most common reason for failure. To support this preparation, this subchapter introduces the M&A transaction process and chapter 3 focuses on the due diligence, where the foundation for a successful preparation is established. Practice has shown that only a part of all M&A transactions is successful. An integrative M&A process, and thus a systematic analysis, is a prerequisite for a positive M&A transaction. Phasing models underlie the reasoning that systematic planning increases the probability of a positive outcome (Simmons, 2008, p. 8).

Commonly, the M&A process runs in a chronological order. But some authors suggest that the phases do not necessarily follow this chronological order, but have to be seen in an interactive and integrative perspective (Ibid, p. 9).

Figure 4: The M&A process

Source: own drawing based on Lucks & Meckl, 2015, p. 99

Usually the M&A process is divided in three phases: the so-called acquisition management or pre-merger phase before the acquisition, the deal phase or transaction phase and the post-merger phase, also called integration phase. In some cases, even a fourth phase, the demerger phase, can be observed when the acquired company is sold out again or is split off, as a result of failed integration or failure to implement synergy potentials (Wirtz, 2012, pp. 116–124). The fourth phase will not be subject of this paper, because if utilizing the due diligence correctly, this phase it is never expected to occur.

As observed, M&A transactions have a complex process. From the pre-merger phase, the negotiations to the post-merger phase, each deal is different and will face different challenges. This standardized process remains basically unchanged in an

international deal, but the fact that they are even more complex than domestic deals. The number of parameters to think about and anticipate a pre-deal level in an M&A deal is huge. Legal, political, tax, labour and cultural differences to the buyer country add more complexity and risks to the transaction process (Wübben, 2007, p. 49). In return, firms tend to enlarge and deepen the due diligence analysis.

The pre-merger phase is initiated by an analysis about the acquirer strategic options to discover its strategic gaps. After deciding for an external growth, a M&A, the company should set up objectives for the transaction (Simmons, 2008, p. 10). This planning phase is characterized by a non-binding nature and determined mainly by the strategy development, organization of the acquisition process, the search for a suitable target company as well as an initial analysis of this company (Lucks & Meckl, 2015, p. 98). In comparison to domestic deals, specific risks in an international deal are a false assessment of its own competitiveness in a foreign environment, an overestimation of the growth potential, or the generally more limited availability of information. Regarding the screening of potential target firms, the evaluation of compatibility of cultural fit of the target, for instance its leadership styles or hierarchy orientation, requests special attention. Additionally, the initial contact normally poses an extra challenge, because of the differences in the local habits, perceptions, and negotiation styles (Wübben, 2007, p. 49).

The transaction or deal phase is actually the “deal making” phase, when both parties will negotiate. According to the old literature, this phase also includes a due diligence process and the evaluation of the target, and thus forms an essential part of the M&A process. In chapter 3, the new view of this process will be presented. The due diligence is particularly important as it identifies possible synergies, and it is the basis for the risk management (Simmons, 2008, p. 10). In an international transaction, the due diligence is mostly more challenging, given that the acquirer must familiarize itself with a different institutional environment, differences in the taxability of the various transaction structures, specific laws governing the compensation and social welfare of employees as well as their termination. Above all, insufficient knowledge of the circumstances in the target´s business environment may lead to overlooking significant potential risks that are not sufficiently addressed in the acquisition agreement. Furthermore, for obtaining regulatory approval of the transaction, local authorities of the acquirer and those of the target´s country need to be informed and their specific requirements have to be observed (Wübben, 2007,

p. 50). Finally, the transaction phase ends with the closing of the deal in form of a contract.

The post-merger phase, which is the last phase of a M&A transaction, includes the time after the takeover and comprises the definition of the integration concept, the prioritization and the implementation of integration measures, and the post-acquisition controlling. But the conception of integration should start not just in this phase but during the acquisition structuring and management phase. During the post-merger phase (after closing the deal), the actual implementation of the specified integration measures should take place, “which generally concern strategic (i.e. the consolidation of corporate strategies, transfer of strategic resources and know-how), personnel (i.e. motivating management and workforce of the target), structural (i.e. eliminating divergent or redundant organization and IT structures), and corporate culture aspects” (Ibid, pp. 48, 49). This phase is normally concluded with a post-acquisition audit, a controlling integration, which is an assessment of whether the goals for the acquisition were achieved or not.

It is only in the post-merger phase that becomes clear whether and to what extent the transaction was successful and if the previously identified potentials could be used. In principle, two approaches to the success assessment of M&A activities can be distinguished (Canina et al., 2010, p. 82). The classic approach defines a M&A transaction as successful if the value of the integrated firm is higher than the sum of the acquisition price paid for the target firm and the value of the acquiring firm prior to the merger. So as state by Canina et al. (Ibid), “a successful merger or acquisition is one in which the value of the combined firm exceeds the cost of the total investment”. The second approach defines a transaction as successful if the value of the combined companies after integration is higher than the value of the two separate companies before the transaction. Moreover, the two main sources of a M&A gains are revenue improvement and costs reduction. Thus, regardless of the definition of success, the realization of the synergy through a positive integration is essential (Ibid).

3 Meeting chances and challenges through the due diligence process

3.1 The comprehensive analysis called due diligence

As seen in the chapter before, the M&A life cycle consist of different phases, and the due diligence is a crucial part of the negotiation phase. As stated by Grosbard (2016, p. 205), "The due diligence phase of *any acquisition* can make the difference between success and failure" and it is an introductory and investigative milestone preceding the post-merger integration (PMI) planning activities (Ibid, p. 204).

Empirical surveys show that M&A involves a high risk of failure. If failure in this case is defined not only as the formal collapse of an acquisition, but also the non-accomplishment of its set goals, for example, the achievement of synergy effects, up to 70 per cent of the M&A fail (Wirtz, 2012, p. 204). There are several reasons for this high failure rate, but above all, the insufficient knowledge about the target company and its business strategy. Frequently, synergy potentials are overestimated, so that an excessive purchase price is agreed. In addition, there is often a lack of integration between the acquirer and the target company. These causes can be reduced by a comprehensive analysis, the so-called due diligence, since the failure rate depends essentially on the knowledge of the purchase object (Ibid). But learning about the target, the task of due diligence, is very challenging.

Due diligence is research and part of the buyer's risk management tool set. According to the Gabler Wirtschaftslexikon (n.d.), due diligence is a careful examination and analysis of a company, in particular with regard to its economic, legal, fiscal and financial situation, which is carried out by a potential buyer before the deal is signed. In addition to the buyer, employees of the target company and external consultants can be involved in the due diligence team. This process confirms that all details are correct and is a way of preventing unnecessary damage to either party involved in a transaction. As written by Bruner (2012, p. 208), "Its purpose in M&A is to support the valuation process, arm negotiators, test the accuracy of representations and warranties contained in the merger agreement, fulfil disclosure requirements to investors, and inform the planners of post-merger integration … It is the opposite of negligence".

The emphasis of due diligence is on identifying risks and the real state of issues, minimizing uncertainties and validating initial findings. So, during the due diligence

phase, as much information as possible should be collected in order to reduce information asymmetries and to make subsequent decisions and actions on a secure basis. Thus, in agreement with Wirtz (2012, p. 205) the basic objectives of a due diligence are:

- the gathering of information about the purchase object
- the identification of risks and chances
- the documentation of information of the target company for later evidence in the event of disputes after the closing of the transaction,
- information for the design of the contract and
- preparation of a successful integration management, as the due diligence team should, as early as possible, provide information and recommendations for the integration of both companies

Furthermore, opportunities and risks should be seen as possible consequences for an acquisition. Classical instruments such as SWOT or ABC analyses are also applied during the due diligence. The information obtained in this phase should help to improve the quality of subsequent decisions and actions, as well as to overcome the success-critical aspects and aims that are being pursued with the M&A transaction. The risks identified do not necessarily lead to the abolition of the acquisition project. Rather, the seller can promise to take over the risks or give appropriate guarantees. In addition, such risks may be the cause of a purchase price reduction or the discontinuation of the transaction (Ibid, p. 206).

In general, a due diligence is a detailed and systematic analysis of data and information about a target company within the framework of an intended business transaction, which serves to identify the main influencing factors of the transaction. The concept of due diligence means the necessary care with which the potential risks and opportunities must be weighed against one another before a purchase (Görtz, 2006, p. 521). Hence, due diligence is an important success factor in M&A. Its main goal is the reduction of the information imbalance between the parties involved in a business transaction (Ibid, pp. 523, 524).

3.2 Forms of due diligence

3.2.1 Traditional due diligence

The traditional form of due diligence has been a usual practice for many years mainly to validate financial statements, legal practices, and taxation. Most of the due diligence literature just write about due diligence is this form, with a narrow focus on the financial performance of the target company. The big problem here is that it overlooks many of the critical issues that tend to appear later in the post-merger integration phase. As seen in chapter 2.3, cross-border M&As continue to grow even with a high failure rate. As written by Grosbard (2016, p. 206), “Checking to quickly and focusing too narrowly is often a recipe for disaster”.

Additionally, the traditional due diligence focuses on the target company´s past, i.e. it analyses only past performance and does not emphasize future opportunities. That means, it does not intend to examine the future of both companies together. The motivation is just to investigate the value of the target company and if the deal can be executed. That is why the information sources are mostly only past and present contracts, agreements and past financial statements. On the word of Grosbard (2016, pp. 206, 207), this type of due diligence should include at least:

- Financial statements review: to confirm the existence of assets, liabilities, and equity and to determine the financial health of the company based on the income statement and cash flow statement
- Legal compliance review: to check for potential future legal problems
- Document and transaction review: to ensure that the paperwork of the deal is in order

In conclusion, the traditional due diligence is actually a narrow review, brief, contained, and focused. The disadvantage is that it focuses mainly on the legal and accounting issues necessary to get the deal done. The thrust of the research is disaster avoidance (Bruner, 2012, p. 210).

3.2.2 Integrated due diligence

Even well-managed companies can be infected by deal fever when the acquisition is once in sight. Due diligence is often limited to verifying the published financial statements, instead of checking the strategic logic of the deal and precisely

analysing whether this really creates a significant company value for the acquirer. Due diligence insufficiency is a major contributory factor to the high failure rate of M&As. As several empirical studies prove, about 70 per cent of all major M&A deals fail, when measuring its company value. To find out the reasons for this, worldwide surveys among 250 managers with M&A experience were conducted in December 2002. In addition to integration problems, the insufficient due diligence was on the top of the deficiency list. In total, only 30% of M&A executives were satisfied with their due diligence processes, as regard to thoroughness and consistency. And one-third admitted to have deals, at which they had serious doubts (Wisskirchen, 2006, pp. 361).

“One of the most important parts of making a deal successful after you complete it is what you do before you complete it” (Galpin & Herndon, 2014, p. 57). This new approach of due diligence must be addressed, as more and more M&A transactions fail for not conducting sufficiently broad due diligence. This is supported by more one survey of ninety-six firms, reported by Galpin & Herndon (Ibid, p. 58), representing more than US$ 568 billion in deal volume across Asia, Europe, Latin America, and North America, which found that companies are spending minimal time identifying the human capital risks and opportunities inherent in each potential M&A transaction.

As observed in the section before, most acquirers perform due diligence only in the scope of the traditional due diligence - a quick and narrow due diligence process, concentrating only on the past and not on the future of the merged companies.

Though, in the near past, a new due diligence movement has emerged, the so called “360-degree due diligence”, others call it “integrated due diligence” or even “strategic due diligence”. The main revolution is to not only audit past performance but to also identify potential vulnerabilities or opportunities, i.e. it also looks toward the future and takes into account the possible synergies as well as the integration process (Grosbard, 2016, p. 219). That means, the due diligence is not solely performed to check the differences between the companies but is also analysed in comparison to state where the merged company should be after the merger. This designates that following the due diligence, an initial PMI plan should be assembled. As stated by Grosbard (2016, p. 205), “The details one discovers in the due diligence phase will suggest how to integrate the acquired entity with the acquiring company.

If due diligence is the gathering of information, integration is the implementation of what you discover. The two parts of the process go hand in hand".

Moreover, empirical studies show that the integration phase is crucial for the success of M&A transactions. Accordingly important is the estimation of integration potentials (chances) and risks or challenges already in due diligence phase, being this one of the key to a successful integration (Görtz, 2006, p. 529), because due diligence is the foundation for a positive post-merger integration. Integration planners begin their work after the signing of the definitive agreement and findings from the diligence review. So, the diligence team is responsible for giving recommendations for the integration phase (Bruner, 2012, p. 214).

Thus, this new approach asserts that conducting a traditional due diligence, based only in few areas as financial and legal, is not enough, all other functional areas should be checked as well, such as operations, sale and marketing, human resources, research and development, among others. Most of the problems in the post-merger are in every area but financial and legal. Therefore, the process of due diligence should be broader, looking toward the future and being a basis for the PMI phase (Ibid, p. 219).

By some executives, the process of due diligence might be considered a waste of time because of the onerous tasks of gathering information. Nevertheless, the abundant failures of many M&A have shown that if companies have had a more comprehensive due diligence before the close of a M&A contract, many of the pre- and post-merger problems might have been foreseen and surpassed beforehand. So, this type of due diligence contributes to a positive PMI (Gleich, et al., 2010, p. 120).

Furthermore, successful buyers are aware of the strategic importance of due diligence. As a result, they are not only deeply involved with the financial data, but they also carefully examine the strategic dimensions of the deal. That is, they look not only at the target object but the entire deal in the strategic context. They choose a highly disciplined and objective approach. The top management is very attentive to the results of the investigations and analyses, and they are always ready to take the consequences and to burst an unsatisfactory deal even in an advanced stage. For these companies, therefore, the strategically oriented due diligence is the

necessary counterbalance to the hectic impetus that quickly arises as soon as the M&A executives have focused on an acquisition target (Wisskirchen, 2006, p. 362).

According to Wisskirchen (2006, p. 363), there are basic questions, that should be asked and answered before an acquisition agreement:

- What is being really bought - which customers and competences, which cost structures and which competitors?
- What is the stand-alone value - the company value of the acquisition object?
- What are the real synergies and where are possible pitfalls? (Chances and challenges).

As important as the financial due diligence is, based on past data, it remains ineffective without the forward-looking art of strategic due diligence. In the face of so many failed M&As, more and more companies are beginning to realize that there is no better way to invest precious management time and the money of capital providers than in the careful and comprehensive analysis of an acquisition target. An effective due diligence is also an exercise in management patience. It is all about checking every assumption and every belief set - and above all, not succumbing to the thought mistake, you can solve any problems after the transaction is completed. There is often a certain arrogance in the corporate group which leads to unnecessary mistakes in the M&A process, mistakes that can cost millions or billions of dollars or euros (Ibid, pp. 373, 374).

In the case of cross-border M&A, macroeconomic factors as well as information on the legal and political situation should be considered. Such an analysis of the overall economic framework can be also called external due diligence. In addition to political, legal and political analyses, external due diligence regularly examines the socio-demographic structure and the level of education in the country in which the target company operates (Wirtz, 2012, pp. 208, 209).

In an empirical research conducted by Sacek (2015, pp. 20-25), the linkage between the organizational exploratory learning and removing information asymmetry has been proven. The results indicate that there is a positive correlation between successful M&A transactions and appropriate scope of due diligence proceedings.

This new approach of due diligence teaches that acquirers should think like an investor to have a foundation for M&A success. That means, they should inspire an

attention not only to risks, but also to returns. Weather the traditional due diligence teaches to focus narrowly on risks, to adopt a compliance mentality that easily reduces to checking lists. On the other hand, as reported by Bruner (2012, p. 209), "an investor mentality goes farther: it seeks to gauge the risk exposure and the investment attractiveness of the target. To think like an investor during a due diligence review is to assess critically both risks and returns; to understand opportunities as well as threats (strengths as well as weaknesses)", i.e. thinking like an investor is less about avoiding future legal proceedings and more about wise acquiring. So, the due diligence should be a broad review, that takes the time it needs, and makes large demands on the target. It should be also viewed as the foundation for valuation analysis, deal negotiation, and the organization of post-merger integration processes. Therefore the acquirer should analyse and know the chances and challenges of a transaction; the past, present, and future of the combined firm; its partners, such as key customers and suppliers; the financial condition; and internal and external conditions of the firm's environment (Ibid, p. 211).

In terms of the timing, due diligence should be characterized as a series of diligence exercises at different phases of the transaction process where each phase of diligence has a different emphasis on discovery (Hunt, 2011, p. 723). So, the due diligence process should go along with a transaction from the pre-merger to the post-merger phase, it is a continuous process that should be done repeatedly, ensuring a positive post-merger integration. The information gathered by a broad, strategic and integration-oriented due diligence produces important findings that must be remedied at the earliest possible opportunity for the deal to be successful in order to prevent surprises after the deal is done (Galpin & Herndon, 2014, p. 62).

3.3 Chances presented by cross-border M&A

3.3.1 Market entry opportunities

The increasing globalization has elevated the opportunities and pressures to engage in cross-border M&As. An international M&A represents a relevant opportunity for an international acquirer, which is the market entry strategy to distribute existing products or to gain access to new and lucrative markets, providing a form of geographic diversification, which in turn expands the market for a firm's

current goods. Normally it is difficult to enter new markets because of the multiple entry barriers and the different legal, political and market conditions. Additionally, the relationship with foreign suppliers and distributors can be complicated, thereby making it difficult to enter a new market and operate successfully. Nevertheless, when you acquire a firm that already exists in that market it is easier to overcome these entry barriers (Hitt & Pisano, 2003, p. 134). Through a M&A, the buyer acquires named brands and operational experience in the local market, as well as access to established relationships with suppliers, clients, and local authorities, that can help the buyer to meet local demand or product specifications (Simmons, 2008, pp. 4, 5).

As reported by Simmons (Ibid), this was demonstrated by the Vodafone growth strategy focusing on M&As in emerging countries. In 2007, Vodafone communicated the biggest acquisition in Indian history (USD 18.8 billion) of a major share in mobile network operator Hutchinson-Essar. With this purchase, Vodafone secured access to one of the biggest mobile phone markets in the world.

New market opportunities can also provide economies of scale and bringdown the operation costs. As a result, cross-border acquisitions provide a form of potential rapid growth to the firm and can enhance its profits. Because of the international expansion, cross-border M&A can provide the acquiring firm with market power. The economies of scale and scope can make firms more efficient and allow them to become increasingly effective in the use of their resources (Hitt & Pisano, 2003, p. 134).

3.3.2 Learning and innovation opportunities

M&A can reinvigorate acquiring firms and so promote their long-term survival. This results from the opportunity to learn new knowledge, know-how and capabilities from the acquired company. This kind of chance is especially strong in international M&A because societal and corporate cultures in managerial practices often differ across country borders, permitting the acquiring firm to learn new abilities. This new knowledge may come from new product or process technologies, managerial skills, marketing, logistics, or other important areas within the acquired firm. Therefore, M&A transactions can be described as a learning process, as such knowledge transfer and diffusion are conducted as an internal process, different than others

mode of entry, e.g. greenfield ventures and strategic alliances (Hitt & Pisano, 2003, pp. 134, 135).

Furthermore, the acquirer can have access to research, development assets and intellectual property of the target company. Some countries have developed specific environment that play in favour of research and innovation. This is, in particular, linked to their educational system, their infrastructure, and their cost (Ourvoie, 2016, p. 25). In addition, the acquirer can search for target firms with new products or technologies that are developed and ready to enter the market; or also gain access to new knowledge and other types of resources that support its innovation capabilities. Conforming to Hitt & Pisano (2003, p. 135), internationally diversified firms have higher levels of innovation and are exposed to new ideas and new product development processes. Furthermore, international diversification provides larger markets from which to earn returns from innovative products.

3.3.3 Access to resources

Another important opportunity is the control of a particular resource that is produced in the country of the target, such as agricultural or other natural goods. However, it requires attention to the contracts of ownership, exploitation, distribution, and any restrictions to produce, sell, and export. In many such deals, there may be consideration related to local political interferences and geopolitical risks . (Ourvoie, 2016, p. 24)

Moreover, cross-border M&As occur to obtain complementary, valuable or unique resources that supplement their current resource portfolio in order to gain a competitive advantage. Since markets have become more global, the competition has become stronger as well (Hitt & Pisano, 2003, p. 135).

Thus, can be concluded that international M&As provide several chances. Nonetheless, these cross-border transactions also address numerous of substantial challenges to managers intending to acquirer or merger with a foreign firm, that should be taken into account during the due diligence process.

3.4 Challenges of cross-border M&A

3.4.1 General considerations

As seen before, M&A is a complex process and international deals are even more complex than domestic ones. The number of parameters to think about and anticipate in an M&A transaction is huge. From the pre-merger phase, the negotiations to the post-merger phase, each deal is different and will face different challenges. In return, firms should enlarge and deepen the integrated due diligence process, because there are always several variables surrounding the transactions that can be analysed and thus, improve the integration outcome.

Firm-specific (microeconomic) forces should be considered. A firm´s growth rate, its investment decisions, its compensation policy, its manufacturing organization, and its acceptance of risk are elements that may differ from one firm to another. The managerial decisions, such as, to invest abroad, to acquire versus to build a joint venture or have greenfield approach, are partly constrained by internal parameters and their perception within the firm. All these different elements may explain the interest of a cross-border deal, and may ease or hinder its execution. Additionally, perceptions, corporate history and internal culture are as important as the facts and financial figures themselves (Ourvoie, 2016, pp. 28, 29). Also Industry-specific forces must be identified, because there are also major differences from one industry to another in terms of economic forces at stake and their relation with M&A deals (Ibid).

Furthermore, country-specific (macroeconomic) forces should be deeply reviewed before an M&A transaction. According to Ourvoie (2016, pp. 30, 31), there are many examples of differences between nations regarding “collective priorities, regulations, investments, and public demand. Lobbies, media communication, industrial dependencies, and perception of risks do influence such sector-based changes. Transport, defence, health care, and public services are all indicative of major differences between nations as to what people expect from firms in terms of quality of service, productivity, costs, and so on”. Political and legal framework conditions can limit the company's scope of action. Differences in the market structure can open new strategic possibilities for the company, but also provide integration barriers. Furthermore, cultural differences can make the cooperation of the partners and the integration of the businesses more difficult.(Böhringer et al., 2006, p. 138)

In the following, some important firm-specific elements will be analysed, such as differences in corporate cultures, different organizational routines, managerial practices and styles, communication systems, among others; as well as some country-specific elements, including the different institutional environments between the two firms' home countries and their two different national cultures. Firms are embedded in a system of social and cultural norms that certainly affect the processes and outcomes of cross-border M&As (Shimizu, et al., 2004, p. 325).

3.4.2 Firm-specific factors

3.4.2.1 Analysis of functional areas

The company's internal structures and processes must be set up for the M&A activities. In the case of large, already internationally active companies, an integration can also prove to be particularly difficult.

An affected functional area is the human resource management. It must not only focus on the task of integrating employees but also to select some employees to help in the integration process. The selection of these employees poses a special challenge. (Böhringer et al., 2006, pp. 145). Additionally, a human resources due diligence is needed to identify human resources risks. Human resource refers to the target company´s management team and broader employee talent pool, as well as the programs and infrastructure that help the company to attract, retain, and motivate that talent. According to Grosbard (2016, pp. 221, 222), acquirers should focus on identifying human resource management risks; determining the availability of fitting interventions for mitigating identified human resource management risks; determining employment costs of the prospective business; assessing organizational leadership models; and assessing the human resource management process of the deal.

Operational and supply chain areas should also be analysed during the due diligence phase. It intends to check for potential additional value to be brought out of the target company by improving its operational function. It aims to find "quick win" opportunities to improve performance. It also intends to confirm if there is compatibility between the business plan that has been provided with the existing operational facilities plus the capital expenditure that is outlined in the business plan. In agreement with Grosbard (2016, pp. 222, 223), the areas of focus are: inventory

analysis, outsourcing, cycle time, customer service, supplier performance, forecasting accuracy, risks, among others. The main attention should be on those that are poorly aligned, underutilized assets, and redundancies with and intention to improve operations while leading to savings through increased asset effectiveness, improved efficiency, and automation (Ibid).

Another area that deserves awareness is the marketing and sales due diligence, considering aspects as the strength of the brand, and marketing and sales organization; the perception of product or service quality; the effectiveness of sales and marketing efforts, in terms of coverage, cost and profitability; the competitive advantages or disadvantages; the opportunities for improvement and potential synergies; the outlook for future performance, and others. In this procedure, the characteristics and attributes of acquirer's and target's business development systems and capabilities are compared in order to uncover revenue enhancement synergies that will support the long-term vitality of the combined firm (Bruner, 2012, p. 220).

Information technology due diligence is also very important. It involves checking the IT ecosystems in both companies, analysing what types of systems exist, level of implementation and integration of business and operational processes in between the company/corporate and subsidiaries, as well as cross-company. Following, there should be a gap analysis in between the current processes versus actual needs and systems and infrastructure as well (Grosbard, 2016, p. 224).

3.4.2.2 Difficulty in evaluating acquisition targets

Identification of appropriate targets requires a comprehensive due diligence. In addition, evaluating the financial assets of target firms can be difficult because of differing accounting standards in separate countries and issues of fluctuating exchange rates. Nevertheless, the due diligence should go beyond the investigation of the financial assets and health of the firm to be acquired. The firm's intangible assets need to be evaluated as well. This process is complicated even in domestic acquisitions, but still more difficult in international ones, because the precise evaluation of intangible resources may require understanding about the educational system and skills and capabilities of the workforce, for example. Additionally, the acquired firm's reputation is also important for the evaluation of the firm. Lastly, the

assessment of critical environmental conditions can alter the evaluation process (Hitt & Pisano, 2003, p. 136).

Moreover, the determination of an appropriate price also requires an estimation of the future market value of the assets to be acquired. Certainly, the future market value is partially based on the extent to which potential synergies exist and can be achieved between the acquired firm and acquiring firm assets. But some of the synergies are even difficult to be estimated (Ibid, p. 138). Sacek (2015, p. 21) wrote about the phenomenon of the "synergy trap", indicating the effects of overvaluation of financial position, which carry the risk of forecasting unrealistic growth of the target firm.

So, the stock market evaluation is very important, price-earning, price-to-book, price-to-free-cash-flows are all rations that provide an evaluation of the value of a company and therefore its capacity to buy or to be bought. The deal Nokia (Finland) versus Alcatel-lucent (France-US) is a good example for that (Ourvoie, 2016, p. 33). Nokia concluded the acquisition of Alcatel-Lucent in November 2016, completing a rapid purchase and integration of the firm (Nokia, 2016). During the pre-merger phase, the two groups were about the same size in sales and in number of employees, but showed a huge gap in terms of profits and market capitalization. Based on the pre-merger market values, Nokia could represent about two-thirds of the combined value, i.e. certainly not a merger of equals. The timing could be a differential in this case. If Alcatel-Lucent could have delayed the merger and improve its profits, it would have modified the fusion conditions and its capacity to decide on the future strategy (Ourvoie, 2016, p. 33).

Those are the issues why international deals ask for a certain degree of sophistication in financial terms. The valuation of a firm requires the use of methods such as discounted cash flow analysis (DCF), concepts such as the weighted average cost of capital (WACC) and estimates of different types of risk-related rates (risk-free, country risk, firm risk, currency exchange risk). Besides that, the analysis of the best funding strategy as well as tax and legal impacts and optimization options are required, which is not easy to understand, rationalize and model. International transactions cannot be successful without an adequate level of corporate finance, tax and legal skills to analyse, plan and deliver. Also, a good managerial leverage

of such skills is required. Many deals were found unsuccessful because CEOs overcentralized decisions without the right technical know-how (Ibid, pp. 32, 33).

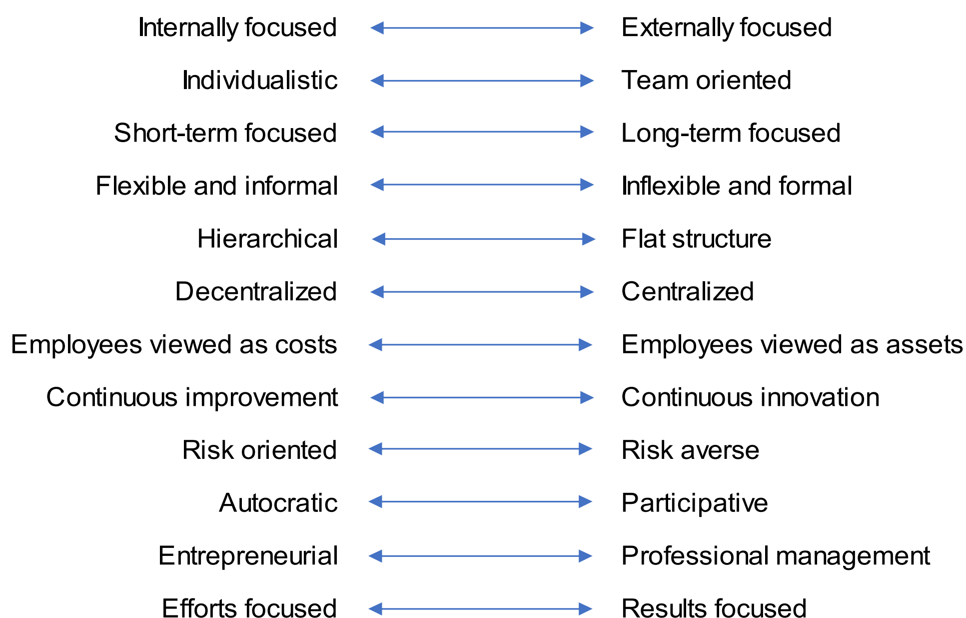
3.4.2.3 Different strategic orientations and corporate culture

Normally, firms headquarter in different countries have also different strategic orientations due to cultural and institutional contexts in which the firms operate. This can also include the differences in the propensity to take risks, which can have a major effect on the outcome of acquisitions. As stated by Hitt & Pisano (2003, p. 137), “If the acquired firm’s managers have a high propensity for risk taking, but the acquiring firm managers are more conservative, there is likely to be conflict in the types of strategies and actions desired by these sets of managers”. These managerial strategic orientations and practices can affect the ability of acquiring firm managers to effectively integrate the acquired firm and to create value from the new merged firm (Ibid).

A solid understanding of the corporate cultural implications and differences is needed. Corporate culture here “is the set of entrenched behaviours that define how companies get things done”. Therefore, firms should start during strategic selection, initial negotiations, and while conducting due diligence a corporate cultural assessment to seek out the differences in both parties and to highlight them (Kessler, 2016, p. 108).

The next figure illustrates a corporate cultural assessment tool, where both companies can be compared. Firms should understand the difference and similarities between their own behaviour characteristics and those of the target in order to facilitate the design of change management activities that will bridge both behaviour sets (Kessler, 2016, p. 108).

Figure 5: Corporate cultural assessment



Source: own drawing based on Kessler, 2016, p. 108

So, the strategic and cultural fit of the M&A is the degree of how the target firm's profile enhances and complements strategic orientation of acquirer and thus contributes to his financial and non-financial aims. The emphasis lies on the suggestion that the more similar the business models and served markets and clients are, the easier will be to integrate (Sacek, 2015, p. 21).

3.4.3 Country-specific factors

3.4.3.1 Legal, political and institutional challenges

Analysing the political climate and legal environment should be one of the first steps of any due diligence. The deal team is required to address any risks that may come from a politically motivated background such as anti-trust regulations, anti-corruption rules, rules that pertain to investments in certain sensitive industries as well as competition (Kessler, 2016, p. 107). Corporate governance rules should be also considered, international transactions depend on the quality of information and the traceability of decisions. Thus, companies must respect a number of general principles shared at the international level. For example: disclosure of information, integrity and ethics, and so on (Ourvoie, 2016, p. 35).

The German post AG had acquired the former American courier and parcel service DHL in order to expand its competitiveness in global parcel shipping. However, this

was not without difficulties. In 2003, Deutsche Post AG was accused by the Federal Express (FedEx) and the United Parcel Service (UPS) of violating US law, because of DHL's takeover. The Post AG exercised control over DHL Airways, a freight airline. DHL covered the large part of the contract volume of DHL Airways (90%). However, under the US law, the control on aviation companies by foreigner companies is prohibited. So, the Post AG had to sell the DHL airways to private investors. With a license loss for the DHL airways, DHL could have lost its air fleet in the USA. The example shows one of the most complex challenges of cross-border M&A, national, political and legal regulations, which may negatively affect the possibility and the success of cross-border transactions (Böhringer et al., 2006, p. 138).

When evaluating the legal and political framework conditions, it is of fundamental importance to analyse whether a participation in an M&A is possible or not. There are still countries which prevent or restrict foreign participations in national companies in the areas of defence, weapons, financial services, insurance, shipping, press, and broadcasting. In addition to the protection of national interests, the government regulation serves also to the maintenance of competition on the respective markets. Moreover, in order to avoid a dominant position, business combinations have to reported to the cartel authority (Böhringer et al., 2006, p. 139).

Compliance is also an important element supporting or endangering M&A transactions. The concept of risk and compliance has changed a lot over the past years, with an increasing amount of duties in all countries, such as safety and environmental norms, labour laws, financial rations, manufacturing and construction norms, among others, which raised the operating costs. However, there are gaps between countries. Emerging economies do not require the same rigor and level of compliance than do more developed countries, which can lead to lower operating costs (Ourvoie, 2016, p. 37). Tax issues should be also subject of the due diligence analysis. The main concern here is to determine the purchaser’s exposure to possible unpaid taxes of the target and to tax fraud. Also, the tax diligence should try to find alternative ways of doing business that might reduce taxes (Bruner, 2012, p. 217).

In addition to the legal regulations which directly affect the merger of companies, numerous other areas of national law are also relevant for the valuation and

implementation of a cross-border M&A. For instance: contract law, corporate law and corporate governance, labour law, accounting rules, among others (Böhringer et al., 2006, pp. 139–141). Accounting rules are a well-known component of influence on international deals. The standardization of international principles is a real trend, e.g. the rollout of International Financial Reporting Standards, but there are still huge national differences (Ourvoie, 2016, p. 37). So, the investing company should be aware that there will be difficulties in the interpretation of the available financial information. These are, for example, difference in depreciation rules, capitalization options and consolidation guidelines (Böhringer et al., 2006, pp. 139–141). Therefore, the acquirer should have support of local correspondents of international audit firms in order to track and model such accounting gaps (Ourvoie, 2016, p. 37).

However, the existence of legal regulations and the understanding of their relevance in cross-border acquisitions are not sufficient on their own. Attention should also be paid to the institutional quality, political stability and legal security of the target country. For example, in terms of law making, regulatory constraints, the security that exists in order to bring agreed treaties in force at local courts, and the risk that the political circumstances might change through revolution or nationalization tendencies, should be deeply analysed (Böhringer et al., 2006, p.141). Developing economies again have problems in arranging the required conditions to deliver the level of institutional quality if compared to advanced economies. Normally, the deficiency of financial assets leads to corruption, insufficient controls, and unknown corporate risks. “Political instability, a weak state and administration and lack of public sector independence are factors known to play against cross-border deals…” (Ourvoie, 2016, p. 38).

Thus, companies should first address questions around the political investment environment and climate of the target´s country in order to ensure that no time and effort is spent on searching targets that may turn out to be unacceptable or where companies may be prohibited from investing given the legal structure in the given country (Kessler, 2016, p. 107).

3.4.3.2 Differences in economic situation and market structure

For the business combination with a company abroad, differences in the macroeconomic environment, macro development and market structure are relevant. Only the analyses and understanding of such differences enables a successful valuation, integration and strategy formation of the M&A activities.

The gross national product, the purchase power, the development of inflation, the unemployment, are some of the key indicators of the economic situation, which influence the general corporate policy and the valuation and integration of an acquisition target. Companies from the western world are used to enjoy a good infrastructure, a stable currency, a high level of education and relative freedom in resource allocation. However, this is not the case in all countries. Some aspects can lead to difficulties, for example, in the planning of input factors, such as the availability of personnel, technologies and capital as well as the development of wage costs (Böhringer et al., 2006, p. 142).

The size of the national financial industry also matters. The existence of listed firms in well-established and active stock exchanges is an encouraging aspect for international deals, because “it limits the risk of political interference in the deal process, provides a better stock valuation basis for negotiation, increases funding options and deal-structuring approaches, and may improve future exit strategies if needed” (Ourvoie, 2016, p. 33).

The interest rate level is also an issue that impacts international negotiations. Companies in well-rated countries have access to lower corporate bond rates than their counterparts in riskier places, helping them to fund their acquisition at a reduce cost without having to pay for the local high rates. The positive spread between high foreign rates and low domestic interest rates favours international deals as well as future synergies. National political decisions may have influence on corporate interest rates. In a period of political uncertainty, the spread may be very volatile, for example in 2014, the 10-year government bond was at 18% for Greece versus less than 1% for Germany. Overall, most advanced countries have advantages from lower public and corporate bond rates as compared to emerging countries, which favours geographical diversification and investments in these countries (Ourvoie, 2016, pp. 33, 34).

In addition, international deals have also to consider international gaps in terms of inflation rates. Normally, a high inflation rate can influence negatively the quality of business forecasts, as the capacity to model future sales and operating costs is altered. It should be also observed that in some countries, cost elements for instance infrastructure cost, the minimum wage, may be automatically adjusted to inflation. Also, the Forex rates should be taken into account. In 2015, the euro lost about 20% of its value against the dollar. So, for any US firm considering an M&A in Europe, such a modification may entail some benefits, for example: lower deal price in dollar, increased strategic capacity to target bigger acquisitions. On the other hand, such a euro/dollar decrease reduces the level of potential dividends to be consolidated by the buyer (Ibid, p. 34).

In addition to macro-economic differences, competitive conditions of the target country should be examined, for example the differences in the level of quality of the products and the price elasticity of demand. Moreover, the importance of product differentiation through brand identification must be considered. In developed markets, competitors' reactions are to be expected and taken into account in the assessment of the opportunities and challenges of an M&A. A foreign takeover can cause a drastic change in the national competitive structure, and domestic companies can try to strengthen their market position or prevent the takeover (Böhringer et al., 2006, p. 142).

The gross domestic product growth rates should be also observed. The local market demand is a major factor in deciding to invest abroad, because in mature economies companies face declining market growth rates, when in the absence of any specific technological or other disruption. “The lower the internal demand, the higher the need to look for foreign alternative sources of growth” (Ourvoie, 2016, p. 34).

The development of markets should also refer to technological development in that country. While business combinations in Western countries are likely to have no or just a few differences in product and production technologies, differences in production and communication technology must be taken into account in the case of acquisitions in emerging countries (Böhringer et al., 2006, p. 143). Furthermore, countries may diverge in terms of appetite for innovation and resistance to change, which can be linked to the education of people, the conservative aspects of a society and its image of authority and legitimacy (Ourvoie, 2016, p. 41).

3.4.3.3 Cultural and social challenges

The failed merger between Volvo and Renault as an automotive company "renolvo" in the early 1990s illustrates the importance of cultural differences for the successful implementation of cross-border M&As. During the pre-merger phase, the annual results of the two companies were announced. Volvo had achieved its best results over the past ten years, while Renault experience significant sales losses. Because of the strengthening of Swedish self-confidence, employee and shareholder resistance was formulated against a takeover of Renault. So, the fusion was aborted. In international M&A, cultural management can be a challenging subject. A cross-border transaction has a double cultural problem. In addition to the differences in corporate culture, cross-border M&A also has differences regarding the national culture. National corporate cultures also influence employee retention, corporate processes and company practices (Böhringer et al., 2006, p. 143).

In 1999, there was a considerable doubt whether the "cost killer" Carlos Ghosn, successful in France at Michelin and Renault, would be also able to lead successfully the Renault's Japanese stake Nissan from the severe business crisis, because his radical methods were uncommon in Japan and were regarded as hardly acceptable. But despite personal dismantling of 21.000 employees and the closure of 5 Nissan plants, Ghosn became in Japan a very successful manager. However, the success story of Nissan should not be interpreted in the way that national cultural differences would generally not play a role. The divergence of cultural values and behaviours can lead to different expectations and also to misunderstandings (Böhringer et al., 2006, pp. 143, 144). But the history of the collaboration between Renault and Nissan shows that companies can learn to deal with such differences. The only way to learn that is through a well-done due diligence, giving managers awareness of such divergencies before the closing of the M&A. So, they have time to prepare themselves, to learn how to overcome the differences and use it in their favour.

National differences have an impact on the leadership and management style. There may be a different understanding of what a supervisor's tasks should be, what qualities he should have, and how he should influence the behaviour and motivation of the employees. Furthermore, the communication style differs across countries, not only the idiom but also differences such as low and high context culture. Without the knowledge of these specific context factors, the meaning of words remains

hidden and misunderstandings and conflicts arise (Böhringer et al., 2006, pp. 144, 145).

Also, social and educational aspects differ broadly between nations. In some countries, education is still limited to a small privileged group of people, resulting in a social fragmentation that has major impacts on business practices (Ourvoie, 2016, p. 39).

Some countries have also several languages or dialects, which does not mean that all dialects must be known, but any integration manager should have conscious that language and translation may be a serious concern when managing personnel abroad. The use of diverse languages is also connected to another factor, the type of cultural segmentations or communities, which exist both vertically and geographically. They have their own representations, work patterns, educational specificities, etc. Principally in business-to-consumer M&As, it is essential to understand which are the social communities and to what extent this local configuration will support or disturb the integration plans and financial forecasts. So, local surveys should be the base for such analysis, resulting in a marketing strategy (Ourvoie, 2016, p. 40).

There is also a huge difference in beliefs and values between nations. Western countries are marked by the growing role of individuals, as opposed to local communities or extended families. This influences the way employees value individual performance, reward individual efforts, and evaluate management decision and loyalty. On the customer side, there is a more challenging demand for service and quality. Firms should also learn to deal with customers or employees who have totally different social relations. Thus, from an HR and a marketing perspective, it is important to consider this eco-environment and set of beliefs and priorities, and to adjust accordingly internal services (Ibid, pp. 40, 41).

The post-merger integration is a huge challenge and it is likely to be more difficult to achieve between firms with home bases in different countries. According to Hitt & Pisano (2003, pp. 136–138), "The challenges of integration are affected by cultural differences, the institutional distance between the two home countries, and the differing strategic orientation/ intent of the executives in the two firms". This acculturative stress is normally associated with lower commitment and cooperation by the employees of the acquired firm and increased turnover of executives of the

acquired firm. Consequently, there is lower financial success in M&A between firms where acculturative stress is high. So, where the gap between two countries is high, there is a larger probability of conflict between the managers and employees in the acquiring and acquired firms. However, although cultural differences and institutional distance may create considerable challenges in integrating the acquired firm, they also present important opportunities. As observed in chapter 3.3, the greater the differences, also the greater the likelihood that a company may learn or gain value from the acquired assets (Hitt & Pisano, 2003, pp. 136–138).

Therefore, a cultural due diligence should be seen as a precondition for a positive post-merger integration. The main goal in this process is to identify and outline the cultural strengths and weaknesses of each party, compare the culture of the target firm with the acquiring one to identify the gaps in between the two companies, and prepare a cultural plan (Grosbard, 2016, p. 224).

3.5 Daimler and Chrysler – what went wrong

Some of the well-known M&A failures of history can be tracked back to disastrous or insufficient due diligence. The merger that created DaimlerChrysler was unsuccessful due to the lack of proper cultural and market due diligence, which contributed to the ultimate split of that company back into its constituent parts. DaimlerChrysler only applied the traditional due diligence in order to avoid legal and financial problems. They did not have a proper integrated due diligence, failing to meet the expected chances and synergies, and to face the challenges that came out only during the post-merger phase.

In 1998, Daimler-Benz AG and Chrysler Corporation, two of the world´s most prosperous car manufacturers, announced plans for a US$36 billion M&A that was intended to create a global automotive giant. This case was known worldwide as a pairing between two successful and well-known companies that could not go wrong and looked like a guaranteed success (Gale, 2012, p. 72).

Daimler-Benz, headquartered in Stuttgart, Germany, was founded in 1926. It was a luxury car maker looking to accelerate the existing business through the penetration of fast-growing markets and the development of new products. The intention was to grow its market share, speeding up globalization by establishing new production

platforms for emerging markets. In 1997, Jurgen Schrempp was named as CEO of Daimler-Benz. Schrempp feared about the growth limitations of Mercedes-Benz, because the A-class product was too expensive, with too much high technology for the targeted high growth emerging markets. So, Chrysler was recommended by analysts as the best company to partner with in order to achieve Schrempp's goal of attaining a broader market base (Badrtalei & Bates, 2007, p. 306).

Chrysler situated in Auburn Hills, Michigan was founded in 1925 by Walter Chrysler from the remains of the Maxwell Motor Company. By the mid-1990s, Chrysler was one of the most profitable car company in the world, with its numerous popular cars, minivans and pickup trucks. Bob Eaton, chairman, recognized the overcapacity and excess production in the auto industry to be a problem for future profitability. So, he realized that Chrysler needed a partner (Ibid, p. 307).

The DaimlerChrysler merger was announced in May 1998 as the largest transatlantic M&A in history. When the fusion took place, it surprised the stock markets, the global car industry and the stakeholders and shareholder of both companies. The shock was also huge for the majority of the 421.000 employees of both companies. During the four month deal between January and May 1998, less than ten people had been involved (Riach, 2013, pp. 8, 9), which shows that the team behind the merger, i.e. also the due diligence team, was very small without all needed specialists for the several due diligence areas, being unable to give a proper integration recommendation for that transaction.

But they were optimistic. It looked, at first, as they might succeed, the deal seemed a logical fit between a European luxury-car maker and an American maker of Jeep sport-utility vehicles and minivans. “The product and geographical match seemed ideal; the main task would simply be to reap all the economies of scale in R&D and engineering” (The Economist, 2000). The DaimlerChrysler AG Annual Report for 1998 presented good numbers. Revenues grew by 12%, operating profits increased by 38% and earnings per share were up 30%. They sold 4.4 million passenger vehicles, commercial vehicles and light trucks. Additionally, 19,000 new employees joined the company (Riach, 2013, p. 10).

However, at the time of the merger, Chrysler stock was traded at $84 and after a short period of high value stock price during the first and the second quarter of 1999, the stock value started to drop to the lowest price of $37,75 in November 2000. It

became onerous and they had to dismiss 26.000 employees and close six plants in the U.S. operations. The initially announced "merger of equals" did not last long, what was initially pitched as a merger, turned to be in fact a stock swap acquisition by Daimler. In less than two years, all the top American managers have either retired, left, or were fired and replaced by German employees. The confidence among the American staffs was at its lowest, causing anxiety and low productivity (Badrtalei & Bates, 2007, p. 305).

Close to 2007, the Chrysler arm of the company was losing hundreds of millions of dollars each quarter. The merger had failed, and something should be done. Less than 9 years later, Daimler declared on February 14th 2007 that it was selling its Chrysler division for US$ 7,4 billion. "The marriage made in heaven had disintegrated into a divorce in hell" (Riach, 2013, p. 10). Perhaps between the leadership who planned the merger, there was a lot of agreement and the deal made sense. Nonetheless, for many in the lower ranks of management, cultural differences began to surface. The first issue was the viewpoint that Mercedes was considered the high-value brand, while Chrysler brands were the less-well-regarded ones. Furthermore, management styles were dramatically different, Eaton was solid and low-key, while Schrempp was an adventurer (Gale, 2012, p. 73).

The DaimlerChrysler merger represents difficulties that can arise from a culture clash among employees. Maybe the integration team tried to help employees understand the differences between American and German culture, but the real problems came from differences in management approaches and business practices. The firms had dissimilar values, had different compensation structures and philosophies about how to brand their products (Gleich et al., 2010, p. 167). Thus, it is important to note that not only the national culture but also the corporate culture, i.e. the business practices and routines, firm values, attitude of employees and managers should be taken into account. An integration-focused due diligence conducted before the merger could have avoided this culture clash.

Another problem was the lack of synergies, expected economies of scale failed to become a reality. Daimler and Chrysler had largely separate distribution models and dealers from both sides were unwilling to change it by adding cars at dramatically different price points. Mercedes dealers refused to add Chrysler car to their product mix, which could have been positive if Mercedes had used those Chrysler vehicles

as a way to win market share from European competitors like Opel, Volkswagen, Renault and Fiat (Gale, 2012, p. 73).

There were also production problems because U.S. workers were paid more than their German counterparts. But, the U.S. workers had to be also more efficient because expenses were more tightly controlled as Chrysler worked to make it vehicles as cost effectively as possible. On the other hand, Daimler-Benz was committed to quality despite the cost. So, it became clear, that it was not going to be easy to produce so different cars in the same establishment (Ibid).

Some say that the two sides had too little contact, and Chrysler stagnated, losing money and failing to innovate with new products. Other authors also argument that Eaton did not work arduously before his planned retirement, failing to provide solid leadership for the Americans. With the decay of Chrysler, competitors such as the Japanese automaker Toyota and Honda, came into the market with new models that competed directly with Chrysler´s cars. (Ibid, pp. 73, 74).

According to Riach (2013, p. 10), the reasons for the failure were the contradiction of the two strategies, the lack of attention paid to post takeover integration processes and the lie of the ‘merger of equals’ metaphor. Consequently, the M&A failed to realize any of the goals of increasing shareholder value, implementing operative synergies and enhancing customer satisfaction.

Moreover, the due diligence report proved the classic mistake of focusing only on financial analysis, for example KPIs such as Chrysler's capital employed, return on capital, the operating profits, breakdown of sales geographically; as well as physical assets, and legal issues; but no or little examination of the numerous aspects of organizational culture (Badrtalei & Bates, 2007, pp. 306, 307).

Most of the observed challenges should have been discovered earlier through an adequate strategic due diligence process. Big M&As as DaimlerChrysler normally spend millions of dollars on “due diligence”. “But there is always pressure for the financial and legal diggers to come up with answers that vindicate the hunches of the bosses who dreamt up the deal in the first place. Bosses, for their part, may be falsely reassured by the due-diligence process, unaware that they are often hearing the echo of their own thoughts” (The Economist, 2000). Or as reported by Moeller & Brady (2014, p. 194), the hardest part is to look at the negative factors and challenges of a transaction, and in most cases when managers have already

decided they want to purchase a business, most don´t want to hear this negative side.

Without a solid strategy and with a bad cultural fit, DaimlerChrysler was unable to realize any of the potential synergies (Gale, 2012, p. 75). Once more, the most frequently reason for M&A failures is the lack of understanding between the two parties, that means, an insufficient due diligence.

However, some lessons can be learned from this experience. First, they should have started the transaction with an integrated due diligence process, analysing not only the legal and financial aspects of the transactions but also organizational and cultural aspects, because the cultural clash was one of the main challenges, that could not be surpassed. Culture is a critical factor for the success of an M&A transaction, not only the national culture but also the corporate culture, that must be previously analysed and understood in order to come up with integration methods and solutions.

Additionally, communication between the parties is fundamental for a positive integration. The entire due diligence process should be conducted from both parties, involving employees of both companies. They should be in contact to know each other better, to develop a combined strategy and goals that are desired from both sides.

Finally, they should avoid arrogance. Daimler and Chrysler were very different companies, they came into the transaction with a very different background and totally different perceptions. So, an integrated due diligence could have helped them to understand these differences prior to the closing of the deal. So, they could have learned how to deal with it or decided not to merge, because change is inevitable, and it should be used in positive way, for the growth of the combined company.

4 Making cross-border M&A work

4.1 Strategic due diligence

Each of the M&A phases is important for the later success of the transaction. The entire process must be planned, designed and controlled just as intensively as any of its sub-steps. As seen before, the due diligence should be integrated and should follow the transaction from the start, the pre-merger phase, to the post-merger phase. So, in order to make cross-border M&A work, not only the traditional due diligence but also an integrated or strategic due diligence should be applied.

As observed before, there have been M&A waves, because the M&A market is a volatile market with ups and downs. It is important to have an understanding about the determinants of this waves in order to catch the potential value out of a deal. The M&A market has been dynamic in the last years, but it may also come down very fast. These cycles have major consequences on the prices, the availability of resources, funding, and risk. So, it is important to have a sense of the overall market situation before dealing with a complex cross-border transaction. But the general trend is in favour of international deals. A wider range of potential deal opportunities should be taken into account, because this market is getting more important globally (Ourvoie, 2016, p. 42).

So, the macroeconomic environment and the market structure should be evaluated before the M&A process starts. While the cultural and organizational integration of the company offers scope for action, the structural, legal and political environment are difficult to influence. During the strategic planning, numerous organizations, such as the foreign trade chambers and the embassies can help with the market analysis. They provide investors with initial information, contact information, legal and customs information, economic data as well as industry and market analyses. Political and economic risks are also analysed by rating companies and supranational development banks. Even if the company already has experience with the target country, it is essential to consult experienced experts for questions of tax and liability law and anti-trust conditions (Böhringer et al., 2006, p. 148-150).

Moreover, as international deals are more complex to analyse and execute than domestic ones, they should be better planed. Managers should have a view that strategic factors of success and failure exist at several levels. An organization develops according to economic, regulatory, organizational, and cultural forces

interacting between them at different levels, individual, firm-wide, industry-wide, country-wide, or global, which can be very complex but also provides a wide scope of potential areas, optimization and synergies. Thus, all gaps between the home company and the target company should be identified and analysed (Ourvoie, 2016, p. 42,43).

Although the necessary length of time for an effective due diligence can vary, it is prudent to have a clear and methodical approach, understand the essence of the potential deal, including the investment thesis and key value drivers for the acquirer; understand the specific risk and challenging areas that require focus; manage all requested information; perform detailed procedures including financial analysis, detailed discussions with management, and site visits; provide reports to ensure that the acquirer is aware of all issues so as to meet stakeholder needs. (Grosbard, 2016, pp. 224, 225)

There is no unique recipe for managing the due diligence process, but defining the domains is crucial, because it outlines how the process should be conducted. A successful process should contain the following guidelines: define a deal rationale, clear for all participants, set up governance, structure and routines. There is an enormous difference between a strategic acquisition, where an integration will be following and so the future perspective is extremely important, contrasted with a financial investment where the acquirer is only focused on past performance. So all steps and milestones of the transaction should be clear and specific (Ibid, pp. 226, 227).

Throughout the examination process, the due diligence should use different methods. For example, reviews or analytical procedures, such as performance analysis, structural analysis, analysis of materials acquired through all channels. The objective is to collect the results, discovering irregularities and important issues. Interview is another important method to achieve sufficient communication with every level of the internal hierarchy, employees of different positions, as well as intermediary institutions (Ibid, pp. 225, 226). So, towards the achievement of success in this process, information should be collected by several sources, internally, interviewing management, key employees, middle management, and veteran employees, as well as externally, interviewing suppliers, customers, past executive team members, and so on (Ibid, pp. 219, 220).This step will be very

important for the preparation and implantation of the integration. The due diligence team should be in contact with all stakeholders of both companies in order to give a doable recommendation.

Moreover, a broad approach to due diligence requires qualities of leadership and management at many levels of the due diligence team. They should be knowledge focused, because the best due diligence efforts focus on acquiring knowledge rather than just gathering data. They also should have initiative. The timing of the research is crucial, and should begin as soon as the possibility of a transaction arises, because it takes time. Another quality of the due diligence team is diversity or a diverse range of expertise, such as technical, legal, accounting, HR, IT, marketing, general management, among others, and experience. They should be able to avoid surprises, reduces or manages downside risks, provides a solid foundation for valuation, negotiation, post-merger integration, and business planning (Bruner, 2012, pp. 226–228).

Particularly important in international transactions is local support. Speaking the language and understanding local customs is indispensable for a full understanding of all issues that need to be fully comprehended. Only executing a home-based due diligence can be very risky, can lead to wasted time, missed information, and overlooked key matters. Therefore, firms normally hire local advisors to assist with the due diligence (Kessler, 2016, p. 105).

There are also common mistakes in due diligence that should be avoided, as the lack of planning and preparation, poor communication leading to unnecessary misunderstanding, incompatibility between the skills needed to manage and execute the due diligence, focusing on traditional due diligence and disregarding the additional areas that may be impacted in the PMI phase, lack of proper working environment and hostile attitude toward the acquirer due diligence team (Grosbard, 2016, pp. 227, 228).

Above all, both firms should have a clear and shared set of strategic motives and goals for the transaction. Also, the integration plan should start earlier, not just during the post-merger phase. Doing so, the differences between the acquirer and the target will be better understood, and the potential synergies and implementation costs and delays will be more precisely assessed. The better managers are informed about local matters, the better their capacity to make well-informed

decisions that will accelerate and secure the integration process (Ourvoie, 2016, p. 42,43).

The analysis phase of the due diligence is closed after the gathering of data, analysis and extraction of several outputs, for instance the risks the combined company will face after the closing, the chances and synergies, and actions that should be taken. Then, a go or no-go recommendation should be given. If the due diligence team assumes that the M&A can continue, a "go recommendation", the output should be translated into an initial post-merger integration (PMI) plan, covering recommendations for next steps, and handed over to the PMI team (Grosbard, 2016, pp. 226, 227).

4.2 Integration process

As implied before, the integration process is crucial to the success of an international M&A. Evidently, companies must achieve an effective integration in order to capture synergy and create value. Therefore, managers of both companies should take positive actions to avoid conflict and to encourage cooperation and coordination during the integration procedure. For instance, they must surpass both national and corporate cultural divergencies in the hope of reaching a form of cultural fit. This process should be incremental and interactive in that the employees from both organizations learn to cooperate and to transfer their strategic capabilities to each other. Key personnel must avoid an atmosphere of "we versus them", as occurred at DaimlerChrysler. "Rather, there should be a collective "we" where all see themselves as members of the same team" (Hitt & Pisano, 2003, p. 140).

In addition, the retention of intangible resources such as knowledge, capabilities, and reputation, is vital to the success of cross-border M&As. Nevertheless, research confirms that not only top executives, but also junior managers of the acquired firm often leave quickly after the fusion is completed and sometimes they are not able to transfer their knowledge prior to leaving. Thus, integration managers must highlight the importance of retaining the key talent from the acquired company to avoid losing these intangible resources included in the valuation and price of the acquisition. Moreover, strategic control systems should be used for a positive integration. But this exercise requires managers to understand the business and to exercise control by monitoring the strategies employed (Ibid, p. 141).

Frequently, it is also necessary the use of integration teams for the planning and implementation of the merger. They normally consist of internationally competent employees of both companies. Their aim is to coordinate and implement the integration process. As noted previously, the routines and organizational structure should be cautiously analysed, and the integration team must recommend any changes necessary to successfully integrate the acquired firm´s resources and assets. They also should certify that all routines are known and understood by the employees of both companies (Böhringer et al., 2006, p. 148).

Besides that, the integration team and managers should develop a global mindset, understanding and appreciating the value of diversity of culture and thought. They should search for value in the differences between both companies. By this means, they are more likely to identify and create synergy between different but complementary resources (Hitt & Pisano, 2003, p. 141).

Generally, the high degree of consistency between the corporate and national cultures and management methods between the M&A partners positively influences the outcome of a transaction. Therefore, these "soft factors", in addition to the economic criteria, are important for the choice of the target company and the formulation of the integration measures (Böhringer et al., 2006, p. 150). So, culture plays an important role in the integration process, that must be studied in advance, and treated with respect and understanding. In particular, for a successful integration of two culturally diverse companies, the ability to communicate is of paramount importance, that should be conducted very openly, frequently and honestly (Badrtalei & Bates, 2007, p. 312,313).

Another important area is the integration and involvement of the employees. Personnel management must take special care in human development in intercultural areas. The employees should learn intercultural competences, because this ability to handle cultural differences can decisively influence the integration in the post-merger phase (Böhringer et al., 2006, p. 151). The level of commitment made by the key managers and employees is also critical. Therefore, "employees should be brought into the process as early as possible. Through their participation, creative ideas will be generated helping the company to achieve its goals and objectives, and this will further employees' dedication toward successful implementation of the corporate strategy" (Badrtalei & Bates, 2007, p. 312,313).

Finally, the decisive factor is not only the desire for a M&A, but also the ability to control this difficult process in a targeted way. Overall, the crucial component is the process of growing together, which occur indeed during the integration. Since the ultimate goal of every M&A is not just to go together, but to grow together in order to increase the economic value and profitability of the new company (Grube, 2006, p. 757).

4.3 Due diligence, how it should be done in practice

This new approach of due diligence has not been widely discussed in the literature, being difficult to find examples of firms that report about it. Besides, there is no unique recipe for this process. Firms normally adapt it to their special needs, but there are some points that need to be considered. After a deep research about the subject, some recommendations can be given in order to have a smooth transaction and a higher possibility of a positive post-merger integration.

First, the due diligence process is not just a single part of the deal phase, as stated by the majority of the literature, but it is a continuous process, that starts in the pre-merger phase and continues up to the post-merger phase, as can be observed in the figure bellow.

Figure 6: The due diligence process

Source: own drawing

The first step that a company looking for expansion should do, is an analysis of the own firm, an internal analysis. There are numerous effective tools, that can be used here. A good example is the SWOT analysis, which will examine the strengths,

weaknesses, opportunities and threats of the own business environment and market. Here, the goals and aims of this company should be clear, in this case, the geographical expansion and growth.

As seen in the subchapter 2.1, there are many forms of expansion, business cooperation, business combination (in a narrow sense) – the M&As –, besides greenfield investments, when the parent company builds a subsidiary in the foreign country from the ground up. The M&A has the advantage of a faster growth, because the acquirer gains access to an established market, with established relationships with customers, suppliers and labour force with certainly know-how about the market structure. However, also existing problems and many challenges are acquired, some of them presented in subchapter 3.4.

Through the internal analysis, the company should be able to analyse its own capacity and to know if such a deal it is even possible. After deciding for an M&A, the firm should set up goals for the transaction in order to fulfil its own gaps and search for potential targets. Having candidates from different countries, for example, a previous analysis of country-specific aspects is required in order not to waste time, money and effort on targets that are unacceptable due to national law or anti-trust regulations, or on countries where the legal and political situation is unstable.

For example, Brazil is frequently named as an emergent country, member of the BRICS, the group of major emerging national economies. That is the reason why Brazil attracted a lot of foreign investors in the last decade. But since 2014, Brazil has been in a recession, due to corruption scandals, high inflation rate and unemployment, the impeachment of the president, Dilma Rousseff, bringing political and economic risks and a crises of confidence, which certainly intimidate companies intending to do business or merger with a company in Brazil (See Watts, 2016 and Flannery, 2016).

So, after asserting that an investment, an M&A, in that specific country is possible, after the analysis of country-specific challenges seen in subchapter 3.4.3, the deal phase starts. Here, a further country-specific and firm-specific analyses should be done in order to evaluate the target firm and to check if there is a cultural fit, not only national but also at the corporate level. The due diligence team should involve employees of both firms of different areas and if necessary also external consultants. But it is crucial that both companies work together, setting common

objectives for the transaction and having common goals. Moreover, possible challenges and opportunities should be identified.

At the end of the deal phase, the due diligence team should give a recommendation if the merger is reasonable or not, if the firms combined can achieve more than separately. The final decision should be made, if it is a “go-recommendation”, the due diligence team should give further recommendations for the implementation and integration of both companies. During the post-merger phase, the integration measures should be applied, and an integration team should be responsible for that. This phase should include a change management, because the change of strategies and concepts is certain, and finally a post-merger due diligence, including a controlling integration, that assess whether the common objectives were achieved or not, and if not, what could still be done to improve that.

5 Conclusion

Within this paper, the term M&A is interpreted in a narrow sense, as a business combination, referring to the consolidation of companies or assets. Normally, it includes the fusion (merger) of two companies into a legal and economic entity, or the acquisition of business units or an entire company. The basis for such transaction is always the transfer of ownership rights to the acquiring company and thus, the transfer of actively exercised management and control.

Growing globalization including the involvement of emerging markets has led to an increase of cross-border M&A transactions in the past few years. As seen before, the M&A market is dynamic and volatile. There have been six M&A waves or cycles. During the fifth merger wave ascended this term “cross-border M&A” as a result of the economic boom, internationalization, information and technology revolution and reduction in trade barriers. Cross-border M&A has increased its importance on the market, accounting for 36% of the total volume in 2016. The expectation is that an active international M&A market will continue to grow, as firms face pressure to complement modest organic growth, looking for geographical expansion and international diversification. However, looking at historical statistics, it has been observed numerous uncompleted or unsuccessful deals in the world of M&A market. Therefore, a comprehensive analysis, a deep due diligence, is required in order to increase the possibility of a positive cross-border M&A. The lack of understanding about the process and the phenomenon of M&A per se can mean the failure of such transactions.

Additionally, three main phases can be observed in a M&A transaction, the pre-merger phase, the deal phase and the post-merger phase. While the pre-merger phase is defined by the decision to adopt a specific target, the deal phase primarily includes the valuation of the company as well as the negotiations. The majority of the literature also includes the due diligence process in this phase. The post-merger phase describes the time after the acquisition and the integration between both companies. From the pre-merger phase, the negotiations to the post-merger phase, each deal is diverse and will face different challenges. Generally, M&A transactions are complex, but international deals are even more complex than domestic ones.

Although international M&A can have many common characteristics with domestic M&A, they also have unique and essential differences as well as more challenges

that need to be analysed in order to achieve a positive M&A outcome. There are numerous parameters to think about before a deal is closed. In return, firms need to increase and deepen the due diligence process. So, because of the importance and complexity of M&As, there is a need to analyse more cautiously and understand the chances and challenges provided by these activities.

The traditional form of due diligence has been practiced for a long time, analysing only the target company´s past, its financial performance and legal requirements to avoid unpleasant surprises. So, it overlooks many critical issues that tend to be the reason of many failures. According to diverse empirical studies, the insufficiency of due diligence is on the top of the reasons for a M&A failure. Therefore, this thesis assumes that a new perspective of due diligence, the integrated or strategic due diligence, is a requirement for a positive cross-border M&A.

This new perspective is based on the fact that the due diligence should investigate not only the past performance of the target company but look toward the future of the combined firm. Therefore, future chances and challenge of the transaction should be addressed. Moreover, the due diligence should go along from the pre-merger phase to the post-merger phase as a continuous process. It should help to uncover future opportunities and risks, to identify differences and commonalities, synergies and integration potentials between the acquirer and the target firm in order to prepare a successful integration plan. So, due diligence is the investigation and analysis of information, and the integration is the implementation of what has been discovered. Consequently, a forward looking due diligence should be the ground for a positive post-merger integration.

The main chances presented by this paper were the opportunity to enter new markets, as a form of geographic diversification, gaining access to established relationships with suppliers, customers and local authorities. New market opportunities can also provide economies of scale and reduce operation costs. Additionally, international M&As have the special chance for learning and accessing different but complementary resources, such as a new technology or know-how. These chances are normally more valuable in international deals than domestic ones, due to an increase of the firm´s competitive advantage because of unique cultural and institutional variances.

Nevertheless, previous experience shows that most of the expected chances cannot be met attributable to the insufficient analysis, during the due diligence, of challenges that influence an international deal. The challenges were divided into firm-specific and country-specific challenges in order to facilitate the analysis. In the scope of the firm-specific challenges, the different functional areas of the acquirer and target company should be analysed, as well as corporate cultures, the organizational routines, managerial practices and styles, the communications systems, among others. Besides that, the difficulty in evaluating the acquisition target should be addressed. Under the country-specific challenges are the political, legal and institutional differences as well as divergencies in the economic and market structure. Another important challenge is the cultural and social difference between both countries. Most of these country-specific factors cannot be influenced by the acquirer, and therefore, should be well investigated during the due diligence process in order to ensure a successful integration.

So, this new concept of an integrated or strategic due diligence should be part of every cross-border M&A, because every deal has different requirements and framework. The integrated due diligence is a dynamic concept requiring severe planning and flexible adaptation to changing environment and conditions. It should be done and redone throughout all stages of a deal involving a great number of employees from different areas from both companies. This will generate robust information that should be analysed establishing the fundamentals for a well-planned integration. An integrated due diligence is the key to a successful integration. Empirical studies show that the integration phase is crucial for the success of M&As. The faster the purchased company or the acquired part of the company is integrated, the better. A bad integration destroys value, as observed in the merger between Daimler and Chrysler. Moreover, the due diligence should help in the achievement of the strategic fit between both firms for a better integration.

To sum up, international M&As have become a crucial strategy for firms intending to expand abroad. Considering the high rate of failures and the complexity of such transactions, managers should be better informed about the chances and challenges presented by this strategy, which can be better analysed through an integrated or strategic due diligence. Therefore, the due diligence process is a required comprehensive tool, that must be applied in the pursuit of a positive cross-border M&A, i.e. for a positive post-merger integration.

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V. Declaration of originality

“I hereby declare that this term and the work reported herein was composed by and originated entirely from me. Information derived from published and unpublished work of others has been acknowledged in the text and references are given in the list of references.”

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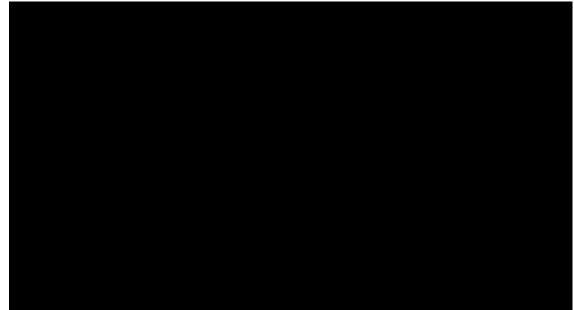

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