Conceptual Part 2

The literature review begins with a high level introduction to M&A in the broader context and then gives a recent, chronological history of developments, highlighting the way in which the focus of M&A research shifted dynamically. Following this overview, the chapter briefly touches upon the topic of acquisition success and then follows a description of business and economic explanations of acquisition motives, showing the variety of M&A theories. Thereafter, Peter Drucker's six acquisition principles are introduced and discussed as they represent a normative requirement for successful acquisitions for the purpose of this study. A conclusion of the M&A literature review section then follows.

2.1 Introduction

By way of a broad introduction, mergers and acquisition are an effective way of aligning the structures of an economy experiencing fundamental changes both in global markets and with the arrival of new technologies. Even if recent increased global competition is not the primary reason for this process, it has accelerated its pace. Schumpeter's (1942) creative destruction of obsolete ideas and structures in order to create new combinations of productive capacities is incorporated in such adjustments. The cost of destruction would be bankruptcy. Now mergers and acquisition enable existing businesses and their employees to be retained with all their knowledge and experiences. In the "restructuring phase", these resources are regrouped and optimised.

Contrary to public opinion, most mergers and acquisition do not restrict competition by creating large multinational companies, but rather enhance competition by promoting competitive pressures. Acquisitions are therefore not a route to large monopolies. As a matter of fact, new companies within new industries are continuously created. It must be mentioned, that the structures that are created by mergers are again exposed to competition. Even numerous tie-ups cannot withstand the force

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of competition. A fact that is often ignored is that acquisitions are accompanied by spin-offs. These outsourced businesses lead again to new companies.

Judging by the headlines in newspapers, M&A are very often considered a threat due to the increased size of the newly created firms. In spite of this, acquisitions are not a threat. All sizes of firm can be managed successfully, however, different company sizes need different management structures and subsequently managers of a special calibre are required. Furthermore, acquisitions do not inherently lead to large monopolies, and size does not mean strength (Malik 1999).

Despite an understanding of the above, acquisition success is not automatically generated. Corporate world realities have demonstrated that the timing of an M&A must be accurate and furthermore, managers must pay important attention to the acquisition integration process. All human aspects related to transformations followed by acquisition are of highest importance.

Acquisitions are typically carried out in a bid to enhance the competitiveness of a company. Ultimately, the consumers and customers are the main beneficiary. M&A therefore do not stifle competition; for example, acquisitions can lead to the restructuring of the core competencies of a company, or they can contribute to repositioning an organisation in the value chain when facing new global challenges. Nevertheless, mergers and acquisitions can only be an effective way of increasing a company's competitiveness if they are handled properly.

The past two decades show increasing activity in spectacular mergers and acquisitions. The prominent "M&A contests" between Rio Tinto and Alcan, Mannesmann and Vodafone, Daimler and Chrysler or Hewlett Packard and Compaq are striking examples.

In many ways, mergers and acquisitions are often unique business transactions. For most firms, acquisitions are relatively infrequent events. This implies that the companies have little experience and often rely heavily on outside help. Furthermore, M&A involve more outside assessment, and therefore increase the pressure to succeed. They typically require a large amount of resources, financially and, crucially, managerially. Contrary to other investment projects, there are no test runs and no milestones at which a firm may choose a different path, i.e. modify or even abandon the acquisition project.

Considering their importance and scale, one would presume that acquisitions are well planned in order to create added value for the organisation. Despite this, acquisition, as one of a firm's most important investment decisions, more often destroys value rather than creating it by strengthening the long-term competitiveness of a company (King, Dalton, Daily & Covin 2004).

Furthermore, it is worth noting that acquisitions still prevail, as most companies still focus solely on shareholder value, which is based on profitability and on growth (Mueller Stewens, during interview).

Companies have focused on profitability over the last few years since the market crash in 2000–2002 and many companies got to the point where it became difficult to further increase their profitability (Mueller Stewens, during interview). Currently, there is a shift in the corporate agenda towards the growth factor. Before the credit crunch, this was supported by the large amount of liquidity available on corporate balance sheets (Interview Mueller Stewens).

Companies' excessive liquidity is not always viewed positively by shareholders and analysts, nor, ultimately, by the market. It is regarded as a lack of ideas from the management (Boutellier, during interview). In order to avoid this and to act against a fall in share prices, several authors argue that this fact led to a momentum of increased acquisition activity in the corporate world, which was not necessarily accompanied by the desired success. In order to do effective deals and to increase success rate, however, managers need more industry expertise (Mueller Stewens, during interview).

One would expect managers to understand the important risk of failure and to therefore ensure that they have all the tools to effectively analyse and execute these transactions. Bad transactions not only waste management resources but destroy the values of both the target and acquiring firms.

Academics and management's well-known thinkers have attempted to create formulas for successful M&A. Despite the tremendous amount of analysis regarding success factors, an explicative theory for the acquisition phenomenon does not yet exist. Still, the majority of acquisitions fail to create long-term value for companies and are subsequently often demerged (King et al. 2004). Ultimately, successful acquisitions require good and effective management and governance.

Major corporate failures based on abuses by CEOs over the last few years have led to intensified corporate governance discussions and regulations around the word. Subsequently, these developments appear to have caused board distrust of executive management and boards have become more sensitised and increasingly critical in approving management proposals.

Any board owes fundamental duty of care to its shareholders and this calls for board members to act prudently and on an informed basis with due deliberation before approving any decisions. Indeed, there are few, if any, strategies that are associated with as much immediate and ongoing risk to the company, target company, shareholders and stakeholders as major acquisitions.

In spite of this, many acquisitions fail to achieve the promised results, destroy trillions of USDs and lead to a psychologically destructive environment for employees. This begs the question: what are the problems and do boards actually have the tools to act effectively in acquisitions?

2.2 M&A Literature Review

The next chapter gives an overview of the way in which the emphasis on different research areas has changed in recent times.

2.2.1 Historical Analysis of Research on Acquisitions Management Phases

The acquisition process can be structured in four phases (McCann & Gilkey 1998). The initial phase is described as the targeting of the seller; the second phase begins when negotiations start; the third phase includes the implementation; and the final phase is described in literature as the integration of the target employees in the new configuration.

Hereafter, to simplify, the acquisition process is structured as two major management phases, *a pre-merger* and *a post-merger management phase.* Furthermore, the way in which research has developed on the topic of M&A is analysed and research deficits are identified.

2.2.1.1 Pre-merger Management

Success of acquisitions has been analysed intensively. Both economical studies and financial theories have demonstrated that at least every other acquisition fails in terms of not fulfilling the expectations of wealth increase for shareholders (Mueller 1980, Jensen & Ruback 1983, Bühner 1990, Cartwright & Cooper 1992).[1]

The literature presumes that misguided motives of managers and their personal interest lead to the excessive failure rates of M&A. Indeed, there is evidence to suggest that managers act in their own interests, for example, to extend their power or increase status. By doing so, they overestimate their ability to successfully handle and lead an acquisition deal (Roll 1986, Jensen 1986, Mueller 1987, Morck, Shleifer & Vishny 1990). Shareholders react negatively to M&A announcements, because they deem their own interests are in danger. Indeed, several authors demonstrated that this is the case particularly when acquisitions are not related to a firm's core businesses, since shareholders do not assume there will be a large synergy effect or complementary business relations (Berger & Ofek 1995). The increased failure of M&A in practice during the 1970s meant that research started to focus more intensively on different aspects of planning (Humpert 1992, Coenenberg & Sautter 1988). This development was simultaneous with the beginning of scientific discussion of strategic planning in firms (Ansoff 1981). Hence M&A became issues of strategic planning. Acquisitions were understood as instruments for realising corporate strategies. During the 1970s and until the 1980s, Europeans firms mostly followed a growth strategy through diversification. The foundations for this were laid down by US example, for instance in the BCG Portfolio Matrix.

This development of diversification, however, was not hindered by regular, new research, which showed that more focused firms perform better than largely diversified, conglomerate firms (Rumelt 1982, Ravenscraft & Scherer 1987a, Lang & Stulz 1994).

Cross-border M&A followed international acquisitions. Research, however, still focused on acquisition success. The research results based on the success of

[1] Depending on Consulting firms (BCG, KPMG, McKinsey) we find failure rates from 50 to 85%.

international as opposed to national acquisition, however, are vague (Doukas & Travlos 1988, Bühner 1991, Hitt, Hoskisson & Kim 1997). Some authors say that the possible reasons for unsuccessful international mergers are things like legal, market, and culture differences (Bühner 1991, Elsner 1986).

Other authors say that danger is inherent to removing management focus from organic growth and specifically innovation (Hitt, Hoskisson, Ireland & Harrison 1991). Contrary to this, Vermeulen and Barkema (2001) say that the short-term distraction of the management and the wasting of resources initiates firm restructuring and fosters the competitiveness of the firm in the future. This conclusion may seem exaggerated, but the numbers of M&A continue to increase despite the huge amount of research in the 1980s and 1990s on M&A failures.

Acquisition continuity has therefore been a challenge in strategic discussions and led to a shift of focus in M&A research. Instead of strategic planning, research now questioned the implementation of acquisitions and, as such, the focus moved to post-merger management. Alongside this shift, theory approach also changed. The resource-based view seemed to better explain the new focus compared to agency theory which became less important. The research shifted from an owner-oriented misbehaviour of management to a that of core competences (Prahalad & Hamel 1990, Wernerfelt 1984, Peteraf 1993). With this, Porter's external strategy orientation shifted to one which was internal. Authors demonstrate that the adequate positioning of a firm in an industry, the ability to select appropriate resources (Makadok 2001) and to combine them (Teece 1987, Milgrom & Roberts 1995) is important for the success of the firm.

The new resource-based view also caused a re-evaluation of intangible assets (know-how, brand, reputation). Hence, research explained M&A failures as the lack of skills to mobilize intangible assets and to make use of them. In this way, organisational and management capabilities that are decisive in making an acquisition a success are at the centre of business research.

The resource-based view later induced discussion on disinvestments, recommending that firm parts that do not add value to a firm's core business should be sold off. Porter (1987) pointed out the impact on competitiveness of disinvestments in the context of acquisitions. Other authors deem disinvestments a result of acquisition failures (Ravenscraft & Scherer 1987a, b, Allen, Lummer, McConnell & Reed 1995). Lambrecht and Steward (2007) noted that takeovers serve as a mechanism to force disinvestment in declining industries. Their arguments lead to takeover transactions occurring mostly in industries that have experienced negative economic shocks.

Defenders of the resource-based theory criticise this "partial" view of M&A. They consider acquisition as only a part of the reconfiguration and restructuring process of a firm and they see acquisitions as a means of readjusting a firm's capabilities and resources (Nelson & Winter 1982, Ahuja & Katila 2001, Capron, Mitchell & Swaminathan 2001). Hence, disinvestments following acquisition reduce their negative character and are understood as part of a continuous process to increase competitiveness in the market.

2.2.1.2 Post-merger Management

Various business and organisational theories have explored how to successfully implement acquisition (Gerpott 1993). Of key concern is finding the best way to eliminate organisational complications generated by acquisitions and to realise expected synergies.

Several authors suggest looking at compatible and complementary resources which need to be created with an acquisition. The process of creating these resources, however, can only be effectively managed if a strategic and organisational fit is present (Drucker 1981, Venkatraman & Camillus 1984, Datta 1991, Naman & Slevin 1993). Hence, the acquired target needs to be similar to the acquiring company in terms of its strategy and organisation. Such similarity should facilitate integration and decrease resistance from the employees.

The defenders of the "fit-argument" say that there is a strong correlation between corporate culture similarities (common goals, values, employee attitudes) and the success of the integration process. In this context, the literature uses the concepts of assimilation and integration (Nahavandi & Malekzadeh 1998, Krystek 1992). While assimilation leads to cultural dominance of the acquiring firm over the target, integration should create a new identity by combining the best parts of each culture.

Regarding international, cross-border M&A, several authors discuss national cultural differences as failure factors (Hofstede 1980, Barkema, Bell & Pennings 1996). There is a clear relationship between "national cultures' divergence" and "acquisition failure" (Chatterjee, Lubatkin, Schweiger & Weber 1992, Gertsen, Soderberg & Torp 1998). Regarding R&D performance, Ahuja and Katila (2001) demonstrate that national cultural distance does not have a significant impact. This result conforms to the research of Weber, Shenkar and Raveh (1996), who did not find any specific integration difficulties in international acquisitions (see also Very, Lubatkin, Calori & Veiga 1997).

Following the considerations of cultural aspects in M&A, research becomes more differentiated and hence isolated issues within the integration process are analysed. In relation to this, several authors found that at the commencement of an acquisition, management-strategists dominate the pre-merger phase (Jemison & Sitkin 1986, Haspeslagh & Jemison 1991). Nondisclosure, leadership image and different remuneration systems do endanger the integration success (Jemison & Sitkin 1986, Haspeslagh & Jemison 1991).

New research looks at acquisitions through a learning and evolutionary approach. Acquisitions are seen as a knowledge-based process and the resource allocation in this process is mainly built on human capital and on corporate governance considerations. Hence, the generation and transfer of implicit know-how is at the centre of research interest (the simple allocation of physical capital becomes secondary) (Kogut & Zander 1996).

Acquisition experience matters. Large, acquisition-oriented companies with a wide range of acquisition experience have an internal process based on guidelines which they use systematically for implementation. Implementation know-how might be a necessary criterion for a successful merger, but it is surely not the only one since the acquisition must first of all be based on an effective strategic decision.

As this brief historical overview shows, over time different schools have looked at various aspects of the issues. Notably, no multi-disciplined approach has been conducted to date. Peter Drucker's acquisition success factors, that are the topic of discussion in Section 2.2.4, are relevant as they include the most critical elements in six pragmatic principles. Before discussing and critically reviewing Drucker's six principles, the topic of acquisition success is explored and an overview of the different schools of thought with regard to the acquisition phenomenon is presented.

2.2.2 Research Approaches to Acquisition Success

Success is an important idea when M&A are planned and executed. Managers tend to base their decisions on the benefit assessments of the acquisition when planning them. Once integration occurs as a result of acquisition, the management assesses if the deal has been a success or a failure. The management's behaviour is therefore impacted by its evaluation of success. It then follows that future decisions are also affected by the perceived success of a given acquisition. For instance, when management believes that an acquisition is successful, it is more likely to make similar acquisitions and strategic moves in the future.

Previous Research on Acquisition Success

Though much has been written about acquisition success, the literature very often tackles research questions such as the success of particular acquisitions or factors which seem to impact, positively or negatively, their likely success. These research studies have been conducted in a variety of ways, the indicators of success have varied, and they have sometimes been implicit. A large number of different explanations have also been developed for the failure and success of M&A.

Different Success Indicators

Stock prices, according to many event studies, served as indicators of success. These kind of studies were popular primarily in the 1980s but since then a number of studies have measured success in acquisitions by using these methods. A company's stock price development is normalised in the context of event studies and this explains the price movements of all traded shares that bear similar risks. After the normalisation of the share price developments, unexpected returns are an indication of the reaction of the stock market with regard to the acquisition. In this approach, a positive or negative stock market reaction measures the success of an acquisition. Singh and Montgomery (1987), for example, have published such studies.

In many research studies, financial performance has been the indicator of success. Numerous studies have examined the financial performance of samples of M&A by using either regression analysis or other statistical methods. Several publications of this type were made before the event studies became popular at the beginning of the 1980s. Later in time for example, Schmidt and Fowler (1990) have published such studies.

In some case studies, financial performance has also been an indicator of success (Vaara 1993).

A number of M&A studies based their success measurements on the evaluations of managers of the involved companies. Subsequently, based on the evaluations of these managers, numerical success indicators were constructed. Studies by Cannella and Hambrick (1993) and Datta (1991) are examples of such research.

Synergy has also often been used as an indicator of M&A success, in particular, in case studies. Vaara (1993) has published on this issue.

Further success indicators have also been used. Porter (1987) used a simpler success measurement in his publications: acquisitions were regarded as failures if they were later liquidated or divested.

It must be mentioned, however, that in many case studies the success indicators are not always explicitly defined. They were mentioned and described in an implicit way in the descriptions of the cases in question. The studies of Ghoshal and Haspeslagh (1990) and Haspeslagh and Jemison (1991) represent such examples in research.

In addition, several studies have used multiple indicators of success. Ravenscraft and Scherer (1987a), for example, combined analyses of stock price and financial performance in their research.

Several Explanations for Failure and Success

Within the acquisition context, the explanations of business relatedness or strategic fit elements have probably received the most attention in research (Singh & Montgomery 1987). The principle argument here is that the potential value added from an acquisition is a function of the relatedness of the businesses of the merging company. According to this view, M&A between organisations in similar businesses should provide more gains compared to acquisitions between companies in more unrelated businesses. However, the empirical research findings with regard to strategic fit have not been consistent (Mueller-Stewens, during interview).

The argument of cultural fit between merging companies has also received broad attention (Chatterjee et al. 1992). The main argument here is that cultural differences are likely to make the merger more difficult. Empirical research has found evidence that clearly supports the negative consequence of cultural differences with regard to the success of an acquisition.

Further to this, a number of studies have looked at the way management affects success in the M&A process (Haspeslagh & Jemison 1991). A key argument here is that the success of an acquisition is very much dependant on the way the acquisition process is managed. From this point of view, skilful management can contribute to success in acquisitions. Likewise, the causes of failure in mergers and acquisitions are often managerial mistakes. The empirical findings are numerous and rich regarding management's impact on the success of mergers and acquisitions.

Several studies have also examined issues related to employee resistance and its subsequent effect on M&A success (Fowler & Schmidt 1989). The main argument is that contested acquisitions are likely to imply unproductive behaviour, a decline in morale and even acts of sabotage, and other behaviours that are not constructive or healthy for organisational performance. The research results strongly support this view.

It is also worth noting that there have been many other explanations forwarded for the reasons behind M&A success and failure. Some researchers have studied the impact of management turnover on acquisition success (Cannella & Hambrick 1993), while others have examined methods of financing as a factor influencing M&A success (Datta, Pinches & Narayanan 1992). Several analyses have also been conducted looking at the effect of the relative sizes of merging firms on acquisition success (Kusewitt 1985). Furthermore, studies have looked at the impact of prior experience in M&A on the M&A outcome (Kusewitt 1985). The pre-merger performance of the acquiree and its effect on the deal success is also of research interest (Kusewitt 1985).

2.2.3 Theories on Acquisition Motives

As mentioned above, over the last years, prior to the financial crises, M&A have become progressively more popular and now represent an important part of today's economy. Acquisition failure rates, however, are still high. For decades, M&A objectives have been of research interest.

Based on the high acquisition failure rate, the obvious question is why do organisations still continue to implement acquisitions? Phrased differently, what are the underlying rationales for acquisitions? In the literature, there are numerous theories attempting to find explanations for the rationales and motives for corporate acquisitions. The focus in this chapter, therefore, will be the theoretical explanations for mergers and acquisitions. The acquisition motives are grouped in theoretical clusters and described. This chapter concentrates on acquisition rationales that predominate throughout economic and business research:

The growing tendency to implement M&A has revitalized interest in acquisition motives (Salter & Weinhold 1982). Because the analysis of M&A deal motives eventually requires an examination of management motivation, assessment of the acquisition process necessitates a brief examination of management goals. This will result in several interesting insights with regard to analyzing current acquisition activities.

Many authors agree that M&A are driven by different motives. Researchers agree that no single approach has explicative power (Ravenscraft & Scherer 1987a/1). Notably, authors such as Ravenscraft (1987/2) demonstrated up to fifteen acquisition motives, ranging from the desire to build an empire, or a monopoly of power to management arrogance. Hayward and Hambrick (1997) offer a more condensed version, presenting only three major acquisition rationales: *firstly*, taking over a unprofitable target company with unproductive management; *secondly*, synergy motives; and finally, management hubris motives (Walsh & Seward 1990).

Trautwein (1990) presents a good overview of the major motives for undertaking acquisitions and are often cited in merger and acquisition literature. Typically, the motives are grouped into three different areas.

Firstly, the real motives: the efficiency theory and monopoly theory. *Secondly*, the speculative motives: the speculation theory and raider theory (Hughes, Mueller & Singh 1980). Finally, the managerial rationales: the theories based on "empire-building" and "managerial-agency".

In the following sections these approaches are explored and the major acquisition motives described along with relevant empirical evidence.

The Efficiency Theories

Often M&A are viewed in terms of synergy in industrial organisation and strategy research. The hypothesis is based on the idea that, as a result of managerial, financial and operational synergies, the joined organisations deliver more merits than corporations working separately.

The operational synergies delivered by acquisitions apply to economies of scope and scale along with experience-based economies. Augmenting volumes on the output side is the basic rationale for an economy of scale acquisition, while reducing the marginal cost of production (Hughes et al. 1980). An organisation can reduce its costs post-acquisition by reorganizing or augmenting its output derived from manufacturing if the corporation is operating beneath the minimum efficiency capacity.

Cost savings can also be achieved through larger volumes of production, as this enables the use of more efficient technology of manufacturing. Despite the opinions of some authors, achieving these advantages is not in fact easy. As Scherer and Ross (1990) explain in their publication, manufacturing plants already exist when two organisations merge and, in the short-term, not much economy of scale can be achieved. If, after an acquisition, only the plant that offers most efficiency is used, one wonders why the other plant was acquired in the first place.

Nonetheless, in the long-term, horizontal acquisitions can contribute to economies of scale. *Firstly*, a merged organisation will eventually possess increased capacity due to replacement (Scherer & Ross 1990). *Secondly*, an organisation with an augmented market share eventually benefits from its size as this can potentially contribute to the purchase of an additional plant (Scherer & Ross 1990). Compared to scale economies that are production specific, product specific economies are less difficult to implement. For this, the merged organisations' process of manufacturing does not need to be entirely replaced but rather reorganized.

The term "economy of scale" is often used too broadly. It is refers to a broad-ranging drop in costs while, at the same time, augmenting the volume of manufacturing. By abolishing the duplication of existing operations, costs that are fixed, such as research & development, marketing and support can henceforth be allocated to an increased number of products. This eventually decreases product cost.

Furthermore, operational synergies that are present in a multi-product company but absent from a one-product company can be generated by economies of scope. However, this is only important when the merger or acquisition expands a company's product range or there are synergistic possibilities such as applying a brand name across different types of products (e.g., Nestlé sell diverse products with identical brand names), similar distribution channels or clientele base. Such synergies may make entering a new market simpler or contribute to achieving a larger market share in an existing one. Apart from that, firms can reduce costs by consolidating strategies. This implies tying up different lines' outlets.

Another potential competitive advantage that arises from acquisitions is the so-called economies of experience. This concept deals with outcomes relating to the learning curve, as well as the transfer of management knowledge between the two companies involved in the merger or acquisition. According to Scherer and Ross (1990), research and development is enhanced when ideas and financial resources enrich the organisation through the acquisition. This rationale for acquisition is often quoted in industries such as pharmaceutics, and in particular when larger companies take over smaller organisations that have a research-focus. Indeed, this was the rationale of Roche when they acquired Genentech (Gerber, during interview). Despite the fact that both economies of experience and scale often compliment each other, they are clearly not alike. Economies of experience create difficulties in comprehension in terms of the employees' knowledge of each organisation, while economies of scale relates to effective utilization of plant and machinery and the technologies of production.

Another motive for an acquisition is managerial synergies. As Trautwein (1990) explained, this type of synergy sometimes accompanies economies of experience, for example, when it is expected that the acquiring firm's management has more developed skills, it will eventually result in the target company's better management. Furthermore, a change in management can lead to the reduction of an organisation's managerial running costs (Scherer & Ross 1990). On the other hand mergers according to Neary (2007) can raise costs, economies of scale and scope is usually achieved through that stage.

Another motive worth mentioning is that of achieving a "market for corporate control". This motive is completely different from acquisitions that aim to achieve managerial synergies. Manne (1965) led the way in developing this idea. Later, Jensen and Ruback (1983) formulated a practical argument for this motive, defining this term "market for corporate control" as: a market in which several management teams compete in order to receive the right to be in charge of managing the corporate resources.

In contrast to acquisition motives aiming to achieve managerial synergies, this new motive which looks to achieve a market of corporate control, focuses on the valuation of an organisation and on the way and extent to which the organisation's resources are utilized. In this context, it should also be mentioned that at the core of this motive is the view that a management team's key goal in running the business is to maximize the shareholder value. An example would be that if an organisation invested in a poor project rather than giving the funds back to the firm's shareholders, then competing firms would discover these "management inefficiencies" and attempt to purchase the firm and then fire the target company's management team. Jensen and Ruback (1983) allege that a divergence from the shareholder value maximization concept is limited as managements of organisations compete against each other for the right to manage resources. Furthermore, the authors claim that this competition enables an environment in which economies of scale and further synergies are created through the reorganisation or combination of corporate resources management.

In summary, it could be said that acquisitions are applied in terms of a disciplined restraint of capital as reparation of the deficit based on hands-on control by shareholders (Jensen & Ruback 1983).

Finally, the efficiency theory category along with financial synergies will be examined as a possible reason for acquisitions (Trautwein 1990). Building on a diversification strategy, an organisation may attempt to progressively increase and enhance its safety and business. Acquisition can also be a means of allowing smaller firms the opportunity to profit from a larger organisation's more favourable capital cost. Lastly, post-acquisition a company can achieve efficiencies by installing an internal capital market (Farschtschian 2004).

The internal market is able to provide capital in a more efficient way based on access to better information (Trautwein 1990). Another reason often cited as an acquisition motive is that savings can be made in terms of upcoming tax events (Ravenscraft & Scherer 1987a). The consolidation of losses and internal fund transfers may reduce the tax requirement of the acquirer company. It should be mentioned that in this example, unlike the advantages described above of efficiency benefits, the tax advantages only benefit the involved organisations. Hence, the broader economy does not experience any gains, but only the involved companies (Hughes et al. 1980).

There is no statistical evidence to confirm that acquisitions are driven by the monopoly rationale based on the described efficiency theories. Research has found fault with the idea that acquisitions result in financial synergies. Assuming that capital markets are efficient, it is difficult to realise synergies. Indeed, Ravenscraft (1987) illustrated that research does not support the argument that acquisitions decrease risks in a systematic way, or improve internal capital markets. The only identified advantages after an acquisition in capital markets were those relating to size (Trautwein 1990). The existing publications covering the utility of acquisition are quite poor. When studying over three hundred acquisitions in the 1960s and 1980s, Auerbach and Reishus (1988) missed the significant tax savings that were a consequence of the acquisitions.

In terms of rationales for acquisitions, a major focus in research was on synergies relating to managerial issues. Considering the published research, the most often quoted rationales relate to efficiency theories (Trautwein 1990).

Analyzing the situation in the United States, Ravenscraft and Scherer (1987a) demonstrated that organisations did indeed achieve some efficiencies through acquisitions. At the same time, their research outcomes documented that in many cases the synergies did not actually materialize after an acquisition. As a matter of fact, the statistics support their argument in that efficiencies typically slump after an acquisition. Trautwein (1990) also agrees with this viewpoint.

Although several authors disagree, many of the measurable gains relating to the efficiency theories have been evidenced by research. As an example, using his "market for corporate control" model, Jensen (1984) was able to show that the activities in the corporate control market consistently augment efficiencies and shareholder returns. On the one hand, efficiencies assumptions have been verified by case studies, but on the other, research findings based on the organisation's tangible productivities refused the rationales relating to the efficiency theories (Trautwein 1990).

With regard to supporters of the view of efficiency in capital markets, it seems that the facts, which are openly available in financial reports, do not correspond to the actual stock prices of the organisation in question. Such discrepancies should not exist. Furthermore, there is no evidence which supports the management substitution rationale as a motivation for acquisition. Building on the theories of Ravenscraft (1987), organisations seek instead for target companies with solid management in place and aim to leave them there. Other authors agree on this point, such as Scherer and Ross (1990). They reject, therefore, that the rationale behind acquisitions is based on motives related to managerial synergies.

The Monopoly Power Theory

The monopoly theme is one of the first topics that research explores with regards to acquisition motives. The monopoly theory considers both the organisation's share in the market and barriers that the organisation needs to overcome in order to access other markets. There is an evident correlation between market entry barriers, the market share of a company and the profits that the company generates. An organisation's power to determine its prices and therefore to augment its profits is clearly positively correlated to its market share and hence its power monopoly.

One of the consequences of horizontal acquisitions is that they lead to a rapid market share increase which diminishes competition in the industry. Conversely, vertical acquisitions can contribute to an organisation's enhanced market position by preventing other entrants to the market. This is explained by the fact that in order to compete successfully with an established firm, a new organisation would need to ascend the market at the same time (Gaughan 2007). Hughes et al. (1980) posits that organisations will eventually face difficulties in a vertical integration, as the requisite management know-how and resources are vast.

Another advantage of an organisation that is vertically integrated is the possibilities in terms of cross-subsidizing some of its products. Trautwein (1990) states that profits that are made in one sector serve to initiate an eventual price war in a different segment or market.

The acquisition rationale based on the monopoly theory used to have greater popularity. In fact, the monopoly rationale along with the speculative rationale is typically considered a principal reason for the huge first wave of acquisitions in the United States over a period of 17 years beginning in 1887 (Scherer & Ross 1990). These acquisitions, whose ultimate goal was to strengthen a company's position, were only of advantage to the involved organisations and not for the broader economy due to the fact that they resulted in markets that were distorted, deteriorated competition landscape, and the transference of wealth from the organisation's client base to the organisation itself. Based on these reasons, several laws were created to restrain such behaviour. As an example of the response to the first acquisitions surge in the Unites States, the first antitrust law was passed at the end of the 19th century, and was called the Antitrust Sherman Act (Scherer & Ross 1990).

Research has not found significant evidence for the monopoly rationale (Trautwein 1990, Jensen 1984).

The Speculation and Raider Theories

This acquisition rationale is primarily of importance for companies that are based on stocks. In the past, the speculation and raider theories had significant relevance and importance during the massive acquisition waves at the turn of the 20th century in the United States.

The organisations that typically helped other firms in their acquisition activities continued to carry out their services even in cases where their clients had a limited chance of achieving a monopoly position in the market. These financial service companies also used tricks to increase their own profits, such as manipulating the market by disseminating untruths and rumours. Consequently, two important regulations were announced in the United States in 1933 and 1934 (Scherer & Ross 1990): The Securities Act and the Securities Exchange.

Nowadays, the organisations involved in promotion activities have much less impact, however, speculation continues to be a delicate matter in relation to acquisition activities. Authors such as Hughes et al. (1980) claim that "today, the inside managers act in the way that in earlier days the promotion organisations would do". In such cases, revenues would not be based on actual economic earnings but rather on speculative investments during the pre-acquisition phase in terms of the target company's stocks. Obviously, the legal framework has changed and such action would not conform to what is tolerated by law.

In order to examine the current form of the speculation theory, one needs to consider Trautwein (1990) and his raider rationale. Trautwein's rationale is often mentioned in research. He views acquisitions a result of the actions of an individual, the so-called "raider". These raiders attempt to make a bid for a corporation and, by doing so, to generate wealth that originally belonged to the shareholders of the corporation. The raiders achieve this goal by various methods, such as "greenmailing", whereby a raider who owns a large amount of the corporation makes the threat that he will bring the company down after the acquisition, unless he receives a significant share premium (Bressmer, Moser & Sertl 1989).

Nevertheless, authors like Trautwein refuse this acquisition rationale, arguing that it is not rational and empirical research does not support it. Empirical research (Traudwein 1990, Jensen 1984) reveals instead that, typically, it is not the acquirer and the acquirer's stockholders who profit from an acquisition, but the company that gets acquired and its stockholders.

The Valuation Theory

Research that looks at the topic of acquisition from a financial perspective, as opposed to a strategic one, assumes that a firm's current market price does not reflect the true value of the organisation. Authors like Trautwein (1990) call this "valuation theory".

Expectations concerning an organisation's prospects, as well as inefficiencies in the market space based on dispersion of knowledge, eventually result in undervalued companies. Evidently, this acquisition theory is relevant for companies that are based on stocks. The acquirer could have a more information than other market participants. Furthermore, it is possible that the acquiring company is better equipped to lead the target company and increase its efficiency and productivity. As a consequence, the acquirer evaluates the company it seeks to take over as being undervalued with regard to its given value in the market. This increases the motivation to take the target over. In these circumstances, synergies are not the primary concern but rather taking advantage of prevailing inefficiencies in the market.

On a further note, the above argument should not imply that there are no ties between the valuation theory and the efficiency theory. As a matter of fact, the rationale as to why an acquirer buys a target that is undervalued rests on the fact that the acquirer considers itself better able to effectively manage the target than its current management. The synergy argument is therefore linked to this thinking.

There are also differences between the two theories. While the efficiency theory focuses on financial gains based primarily on synergy, the valuation theory focuses rather on acquisitions based on financial reasons.

The Empire-Building Theories

Also called managerial theories, they represent an essential trait of the speculation theories. Within this perspective, the managing directors of a company tend to act in their own interests and not those of the shareholders. Several acquisition rationales are based on a manager's personal goals and, more precisely, can be separated into two groups. Hughes et al. (1980) describe one group under their so-called "managerial theories", and Trautwein (1990) investigates the other group under the so-called "empire-building theories". To summarize, the management forms the focus in both of these theory groups, one which acts solely in its own personal interest and diverges from the interest of the company's owners.

According to the research, Baumol (1967) and Marris (1963) are the first authors to classify and describe these two theory groups. They are of the opinion that the company's management strives to achieve major goals which both increase the company's earnings and volume of sales. Neither of these goals, however, are primarily correlated with the increase of shareholders' gains. The rationale for this kind of manager behaviour can be seen as an attempt to fulfil their own personal goals.

It could be argued that managers, instead of focusing on profitability, usually focus their efforts on augmenting their company's size and growth rate as these are strongly correlated with the above mentioned manager goals of earnings and sales maximization. In this way, managers consider growth of their company as an effective means to fulfil their personal ambitions. Interestingly, this theory is strengthened by psychological research which shows that, to some extent, the management aligns its sense of worth with that of the company (Marris 1963).

Managers and shareholders also have a different attitude to risk. Typically, the management is considered to be less willing than stockholders to take risks. Where management's means of existence, including non-financial rewards, depend on the shape of the company, shareholders can diversify their risk into other companies if they wish.

Another acquisition theory to mention here in the context of managerial theories is that of management hubris motive (Roll 1986). Roll argues that the management that is acquiring a target usually pay too high a price. Roll asserts that management overestimates its competence particularly when attempting to effectively integrate and manage a target. As a consequence, the acquisition fails. As explained by Scherer and Ross (1990), the problem of a failed acquisition is exacerbated when managers and chief executives are motivated by the objective of building a huge organisation through numerous and frequent acquisitions, in other words, "empire building". The hubris theory may not explain acquisition actions, nevertheless, this theory presents good arguments as to why executives continue to do acquisitions even though history shows that the majority fail to create value.

At the time of the American acquisition wave during the 1980s, the was a great interest in managerial acquisition theory primarily in business research. In general, empirical findings with regard to the managerial acquisition rationales are supportive.

Nevertheless, several authors reject this theory, such as Jensen (1984). Rather than the empire building rationale, he supports the synergy rationale with regard to acquisitions. Jensen's view, however, is against that of the broader research. Trautwein (1990) gives a good overview of the empirical research outcomes.

Despite broad credibility and some supportive empirical outcomes, the managerial rationales fail to deliver a full account of acquisitions. The managerial theory may apply to a specific example. But taking a broader view on acquisition over time, the managerial theory does not provide strong explicative illustrations.

The Agency Theory

Jensen's (1986) free cash flow rationale, which supplements the other acquisition rationales, is often quoted separately but is actually related to managerial acquisition rationales.

This agency rationale is based on a perspective which can be characterized by a principal-agent relationship. The theory focuses on differences of interest between the owners of a company and the company's management. Although the management is elected by the company owners to run the business on their behalf, conflicts emerge as the management operates for its own interest rather than the objectives of the company's owners. This conflict of interest can be explained through the separation of ownership and control.

Even if the owners could implement an all-embracing monitoring system, it would not be realistic to completely monitor the agent, as the executive managers must always have flexibility in running the businesses.

A consequence of the principal-agent problematic is the complications arising from the employment of free cash flows[2] (Jensen 1986). Some authors believe that

[2] Taking free cash flow to be the excess cash after the funding of an entire project with net present values that are positive when they are discounted at the accurate capital costs.

executives are likely to dispose of such capital flows rather than paying it back to the company's stockholders. In this light, an acquisition of a company can be seen as an instrument to gain control of such flows of capital (Jensen 1986).

Based on this rationale, acquisition activities can be impacted by higher free cash flows. Jensen furnishes practical proof of this argument and he believes this to be a major factor in the explanation of the impressive growth of big American concerns.

The Process Theory

The M&A process theory has its roots in the strategic decision processes. In this theory, the argument is put forward that decisions are not made rationally but rather, are the outcome of processes that are already in place. Obviously these processes are contextual and influenced by the individuals involved.

In this theory, therefore, a company's simple routines, its social and political involvements, and its characteristics such as experiences of previous executives, have an impact on the decision making process and its result.

Jemison and Sitkin (1986) discuss the different environmental and contextual rationales in their publication.

Consequently, according to this theory's argument, some acquisitions are not deemed a result of rational evaluation. A great deal more acquisitions are seen as the consequence of discussed outcomes of an entire corporate decision making procedure. Furthermore, the authors Jemison and Sitkin (1986) propose treating acquisitions as procedures that impact an organisation's agenda and outcomes.

In the literature, the dominant point of view of acquisitions as rational decisions is paired, to some extent, by a process point of view. The latter point of view acknowledges that acquisition procedures are an inherent element of the M&A activity and result (Jemison & Sitkin 1986).

These assumptions conflict with the efficiency theory, which argues that acquisitions are founded on rational decisions.

Compared to other theories, however, the acquisition process rationale is weak as it is not supported by much empirical evidence (Trautwein 1990). A reason for this lack of support may be that executives actually construct their decision in a rational way. Trautwein (1990) supports the theory and argues that it has potential to elucidate acquisitions.

The Disturbance Theory

The disturbance theory is primarily of significance to public companies. The theory is founded on the forecast of a company's earnings based on its stockholder base and those who do not have stocks in the company. Gort (1969) was the first author to write about this theory. He argues that business jolts and crises matter in the formation of forecasts and expectations. These jolts result from changes in technology and also from variations in the cost of security.

According to the disturbance theory, prevailing forecasts and expectancy have to change in order to make an acquisition. The theory postulates that more forecast distinctions are made during moments of duress.

Hence, at times of economic duress, for example, the managers of the acquiring company could become more bullish in terms of the target, while the target's management and its shareholders become more bearish. This difference in view may result in an exchange of company shares and an acquisition. According to this theory, acquisitions take place due to business difficulties and moments of duress. Thus in moments of changing market prices, acquisitions will occur. In particular, during bear markets, acquisition activity should intensify as more significant distinctions appear between the expectations of shareholders compared to those of non-shareholders. In reality, however, empirical research has shown that acquisition activities are more intense in bull markets when the share prices increase, while acquisitions decline with falling share prices during bear markets (Hughes et al. 1980).

On a further critical note, the disturbance theory loses validity because it fails to explain the tremendous amount of acquisition activity towards the end of the 1960s even though the period was not characterized by significant business turmoil. Conversely, acquisition activity should have increased during the 1973 oil crisis, but it did not. It must also be said, however, that there may not be enough instances of duress to make a statistically significant judgment regarding this theory.

Conclusion

In this chapter different rationales for acquisition activities were explored. It was revealed that rationales and motivations for acquisitions are not solely oriented towards strategic efficiency. The various acquisition theories demonstrate that different opinions influence the companies' acquisition activities. These schools of thoughts address different issues and questions, have different objectives and therefore employ different methodologies. Researchers of the theories continue to analyze and investigate acquisition success producing incomplete but relevant research. Indeed, considering their empirical evidence, these theories are logical and partially explicative and so none of them can be fully rejected (Ravenscraft & Scherer 1987a, b).

Nevertheless, none of these serve as a comprehensive explanation for the frequent failure of M&A. As a result, one cannot operate from a single perspective, but rather acknowledge the different research results and the limits of these schools of thought. This is instrumental to understanding the broader issues surrounding acquisition success.

Hence, as the theory overview shows, different schools have looked at different issues at various points. Furthermore, to date, no multi-disciplined approach has been conducted. Straub (2006) took the first step in this direction by combining strategic, organisational and financial elements in his framework to illustrate acquisition outcomes. Straub's study had a conceptual nature, however, and was not tested empirically.

Empirically relevant and widely accepted by academics and practitioners, Peter Drucker's approach appears highly relevant as he includes the most critical elements in six pragmatic principles. In this thesis, these are defined as the normative requirement for successful acquisitions.

The next section presents and critically reviews Drucker's six principles.

2.2.4 A Normative Approach to M&A: Peter Drucker's Acquisition Success Factors

Making an acquisition successful necessitates close attention to human and organisational development. Integration activities require a fine combination of self-monitoring and action. A management which understands the benefits of successful integration makes important alliances with the relevant stakeholders of the target company throughout the integration process.

How do successful acquisitions differ from those that fail? The reasons for failures of previous strategic management research on acquisitions can be grouped areas as follows: *firstly*, strategic reasons, in that the acquiring company targets the wrong firm; *secondly*, integration reasons, in that the acquired company is badly integrated; and *thirdly*, price reasons, in that, typically, too much is paid for the target company (Hayward 2002).

With the exception of Drucker, previous studies on the topic of acquisition have only partially addressed the problem of why such a large number of well-advised acquisitions ultimately fail. The majority of acquisition studies prior to this dealt with individual elements of the acquisition process such as the acquisition motivation, post-merger integration and other isolated areas.

It is evident that a more comprehensive approach is required, which treats the critical M&A issues within a multi-dimensional framework. Drucker postulates that acquisition success is driven by numerous factors and their simultaneous impact on an acquisition.

This study aims to be of practical relevance. Peter Drucker is widely accepted by practitioners and his six acquisition principles outlined below integrate, in a pragmatic way, the relevant success factors appearing in existing literature.

2.2.4.1 Drucker's Six Acquisition Principles

> Very few acquisitions are successful. The reason why most acquisitions fail is because they disregard Peter Drucker's principles for successful acquisition.
>
> Malik, during Interview

Drucker's six principles for a successful acquisition:

1. For an acquisition to be successful it has to be founded on business strategy rather than financial strategy.
2. A fruitful acquisition has to be based on what the acquirer brings to the acquisition.
3. At the core of a successful acquisition there must be a common unity, for example marketing, the market, and technology or core competencies.
4. The acquirer must have respect for the target business, product, the customers of the acquired company, as well as its values.
5. The acquirer has to be ready to provide senior management to the acquired business within a reasonably short period, maybe 12 months maximum.
6. In a successful acquisition clear opportunities for advancement must be visible in both the acquired and the acquiring business.

2.2.4.2 Discussion of the Drucker Principles

> There are six simple rules for successful acquisitions and they have been followed by all successful acquirers since the days of J.P. Morgan a century ago.
>
> Drucker, The Wall Street Journal, 15. 10. 1981.

Building on Paine and Power (1984), Drucker's success principles are based on the premise that the management's actions have a decisive impact on the success of acquisition.

Conversely, Porter (1980)[3] argues that external factors such as the financial health of the target firm, the state of the industry and, more broadly, the economy significantly influence an acquisition's success likelihood. Porter believes that acquisitions happen independently of the management's actions.

The interviews conducted for this research with renowned business leaders who created some of the most successful companies today, strongly support the Paine & Power's assumptions.

1. For an acquisition to be successful it has to be founded on business strategy rather than financial strategy.

In essence, this means that successful acquisitions must be based upon a well-developed business plan, and not solely on financial analyses. The target company should match with the business strategy of the acquiring company. Without a match, there is every chance that failure will result.

In his publication, The Daily Drucker (2004), Drucker reviews the following two case studies with regard to his first principle.

During the last decades of the 20th century the worst acquisition track record of any senior executive was that of Peter Grace, CEO of W.R. Grace. Drucker considered him a smart manager. He set out in the 1950s to develop a multinational enterprise but only through acquisitions that were financially based. Grace put together the most able team of financial analysts and dispatched them around the world in search of potential acquisitions with low price-earnings ratios. Grace then purchased these firms thinking that these buys were at bargain prices. As a matter of fact, the financial analysis that Grace's team did before each buy was impeccable. The problem was, according to Drucker (2004), that the acquisitions were not based on any business strategy.

As a contrasting case, Drucker uses Jack Welch and GE as a prime example of a successful acquirer. Welch shaped the company in an impressive way during his tenure from the beginning of the 1980s until 2001, and to a large extent its expansion was based on acquisition. Almost all of GE's acquisitions were based on a sound and solid business strategy. This resulted in an impressive growth in the company's earnings as well as its market value (Drucker 2004).

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[3] In Paine & Power (1984).

2. A fruitful acquisition has to be based on what the acquirer brings to the acquisition.

An acquisition can only be successful if the acquirer carefully considers the way in which they could contribute to the target company. Crucially, the question is not whether the target firm will contribute to the acquirer. Drucker re-iterates the importance of this, noting further that the potential synergies are irrelevant from the buyer's point of view.

The way in which the acquiring firm can contribute to the target varies in that it could bring benefits in terms of technology, management, or even strength in distribution. Drucker specifies that this contribution must be more than just monetary; "Money by itself is never enough" (Drucker 2004). Hence, before making an acquisition, management must focus on contribution, not synergy.

As an example, Drucker mentions the acquisition of Citibank by Travelers. The acquisition was successful because Travelers conducted an in-depth analysis of the target company and planned, well in advance, what Travelers could offer Citibank in order to bring about a significant change in its operations. Citibank had implemented its businesses successfully in almost all countries. At the same time, Citibank had built a management that was transnational. In terms of services and products, however, the bank was still quite a traditional bank. Its management and distributive capacity, however, exceeded the service and products that typical commercial banking delivered. Furthermore, Travelers had a strong position in terms of product and services, and considered itself capable of handling an increased volume of business based on Citibank's first class international distribution system and management (Drucker 2004).

One could argue with Drucker's second principle based on the fact that it seems to be a limited in that it neglects the potential contributions made by the target to the acquirer. Indeed there are cases where the management acquires a firm as much for what it can contribute to the target, as for what the target can contribute to the firm. This happens, for instance, when a target is purchased to increase the pool of resources, such as talented managers.

3. At the core of a successful acquisition there must be a common unity, for example, marketing, the market, technology or core competencies.

Both companies, the acquirer and target, must share something in an area in which both firms are highly competent. Drucker argues that there must be a shared culture or, at the very least, some kind of cultural affinity. Like all successful diversification that is achieved through acquisition there is a presumption of "a common core of unity". Both companies must share either the same technology or markets. Sometimes, however, similarities in the production process are enough to fulfil the criterion. The same areas of expertise and experience, the same language and so on are elements that bring organisations together. Drucker (2004) argues that without a common core of unity, an acquisition cannot work, as the financial tie-up alone is not sufficient.

By way of example, Drucker cites the case of a large French company that has grown by taking over companies operating in all areas of luxury goods be it fashion designers, champagne, exclusive watches or handmade shoes. At first sight, they appear to be unrelated businesses in a conglomerate, the products do not seem to have much in common. But Drucker argues that all of them are purchased by customers for the same reason: not the price or the utility of the products, but the status gained by owning them. Hence, all the acquisitions in this case have customer values in common, albeit each product is sold in quite different ways (Drucker 2004).

Bettis' (1981) study supports Drucker's rule. He analyzed large industrial companies and realised that the economic success is higher for companies in which hugely diverse areas of activity are related to a specific core competence. Based on his outcomes, Bettis argued that related diversified companies perform better than unrelated diversified companies with regard to their Return on Assets (ROA). Examples include companies like Johnson & Johnson or Bristol-Meyers. This result is, therefore, in line with Drucker's ideas.

Although this principle seems straightforward, Drucker's concept of "common core of unity" can be both broadly and narrowly defined. Large companies typically make several acquisitions. If an acquisition is not related, and therefore does not share "a common core of unity", a subsequent acquisition may share this concept with it and they then become related acquisitions.

Thus, despite the fact that Drucker's principle appears powerful and explicative, the rule is also ambiguous. Above all, defining and recognising a "common core of unity" can be more challenging to define in the moment, compared to retrospectively.

Malik's (1999, p. 252) view supports the Drucker principle:

> The logic of a merger must relate to the market and-or to the technology and be anchored there. Everything else is accompanied by substantial additional risks. If the logic of a merger is not right, nothing will help. There is no way of leadership – not even to the highest level of sophistication – that could compensate a logical mistake within the basic architecture of a merger.

4. The acquirer must have respect for the target business, product, the customers of the acquired company, as well as its values. There must be a "temperamental fit".

A merger or an acquisition will be a failure unless the staff of the acquiring organisation respect the target company, its products, its market, and ultimately its customers. Drucker (2004) cites the example of several pharma companies which acquired cosmetic firms, none of the which turned out to be a success. He argues that "pharma people" and "cosmetic people" have different values. Biochemists and pharmacologists are interested in disease and health in general. Conversely, "cosmetic people" deal with lipsticks and similar products. Thus, pharmacologists do not have similar values to lipstick users. If firms are not respectful or do not have a "comfortable" feeling about the target, their businesses, product range, and ultimately their customers, they will keep making the wrong decisions (Drucker 2004).

5. The acquirer has to be ready to provide senior management to the acquired business within a reasonably short period, maybe 12 months maximum.

Drucker posits that the acquiring firm must be capable of providing top management for the target within a maximum time frame of one year. The acquiring company must be prepared to lose the target firm's key people. These key people are used to being leaders and may not accept demotion to division managers. In the case where these players have ownership or part ownership in the target, the acquisition will make them rich. As a consequence, they will not continue their duties for the firm if they do not enjoy them or like the change. The acquirer must also be sensitive to the fact that the professional managers of the target company, who do not have an ownership stake, will usually be headhunted by other companies, making the shift easy for them. In the case of such a management departure, where the acquiring company is not prepared to provide new management itself, the recruitment of new people is difficult and rarely succeeds (Drucker 2004).

This is particularly relevant in the case of a chief executive who founded the target business. In some cases this chief executive has actually initiated the acquisition process. This CEO may expect the acquiring firm to implement the personal changes that he is reluctant to do. Such changes could include, for example, firing a well-settled colleague and friend, who is underperforming professionally because the corporate environment has changed, leaving this person outgrown by his previous job description (Drucker 2004).

The attempt to keep senior management is usually of higher importance than succession planning for those who leave. It is therefore usual for an acquired company to try to retain the management post-takeover. During discussions, Malik notes particularly the social implications for a target management. An acquisition can create job insecurity for a target management which may be harmful. Indeed, matters related to human relations in acquisition are important for Malik. The top managers of a target company see their status in their private social lives damaged due to the loss of power and responsibility in their jobs.

It is interesting to see that authors like Hayes (1979)[4] have already shown in early studies that in almost all cases, in a study conducted in the late 1970s, where the key people of the target management were retained, the pre-acquisition negotiations actually happened on both social and business levels. It is very interesting to note that the author found out that discussion typically included the wives of the managers.

In order to retain the target's top management, it would therefore seem instrumental for the acquiring company to stress considerable involvement of the target's management in negotiations.

6. In a successful acquisition clear opportunities for advancement must be visible in both the acquired and the acquiring business.

With regard to his final principle, Drucker states that during the first 12 months of the acquisition, it is vital that a significant number of key people from both the acquiring

[4] In Paine & Power (1984).

and target company receive significant job promotions. These promotions need to happen across the companies, meaning the promotion of target company managers to new positions at the acquiring company and vice versa. The reasoning behind this promotion activity is powerful, as it shows and convinces the business staff in each firm that the changes to come will bring them new opportunities. Drucker states that it is very important to be aware that although the acquired business is now legally part of the acquiring firm, politically, the managers of the target become an "us" determined to defend their business against "them", the staff and management from the acquiring company. Similarly, managers in the acquiring company behave and think in the same terms. These invisible and impenetrable barriers can last a whole generation, thus, it is vital to promote key people on both sides within the very first months of an acquisition. This enables managers from "both sides" to see the acquisition as a personal opportunity. In fact, this principle applies not only to top managers or those near the top, but also to the younger executives and professionals (Drucker 2004).

Conclusion: Drucker's Six Principles

The stock market too seems to sense the practical relevance of Drucker's principles. Thus, in numerous instances, report of large deals in the news lead to significant drops in the acquiring company's share price. Despite this fact, to date, managers of both acquiring and target companies continue to ignore these principles, as do the bankers in agreeing to finance the acquisition, because they still, to a large extent, base the deal on financial rather than business concerns.

In conclusion, managers appear to be able to impact acquisition outcomes by acquiring information and planning thereon. Thus, ultimately, managers' skill and experience enable successful acquisitions. The quick implementation of a merger or acquisition is instrumental to success and as well as the high priority of human relations issues.

Hence, albeit that risks are inherent to all acquisitions, following Drucker's principles significantly reduces these risks and creates competitive companies in the long-term.

2.2.5 Conclusion: M&A Literature Review

It is apparent that despite a tremendous amount of research we still face high rates of failure. While most analyses of M&A are conducted within the bounds of the researcher's field, Peter Drucker's principles for successful acquisitions are, in contrast, multi-dimensional, drawing from various different fields. Notably, almost all previous research focuses on management, and, in particular, the chief executive. To date, there is still a lack of the research with regard to the role of boards of directors in the acquisition process.

2.3 Corporate Governance Literature Review

After a general introduction, the corporate governance literature review comprises a discussion of the emergence of boards and a director's duties and roles. Thereafter, the Swiss board system is reviewed and theories of reasonable board stances are suggested. Finally, a conclusion closes the section on corporate governance.

2.3.1 Discussion of the Concept

To understand the duties of a board of directors, the subject of this study, it is important to contextualise the emergence of the board of directors as a controlling body, in the broader corporate governance discussion.

The subject of corporate governance has been discussed in literature for a long time. Debate most likely began with the emergence of larger corporations in which, for the first time, ownership no longer coincided with management. In the late 18th century, control over resources was thus transferred from owners to managers.

Discussion of how to define management tasks and control by shareholders began. Monks and Minow (2001, p. 94) posit that this separation was first discussed by the authors Berle and Means (1932). Other authors even quote Smith (1776), who already discerned problems in the motivation of managers "of other people's money" to the extent that managers' interests do not align with the principals.

The term "corporate governance" has only been in use since the 1980s. As mentioned above, however, the discussion of the concept is long-standing. The earlier discussions mainly came under the topic of "agency theory", i.e., that the disunion between the owners and managers in organisations leads to a principal-agent situation.

Defining the focus of corporate governance as that of directing the company in the interest of its shareholders and on controlling management's actions on their behalf, it is obvious that these two concepts refer to the same research area. Hart (1995) demonstrated the overlap when he explained that corporate governance issues are related to agency and transaction cost issues. As both of these exist in publicly traded companies, agency theory appears to be the basic framework for corporate governance structures.

2.3.2 An Agency Perspective

Many authors consider the focal point of corporate governance to be the agency relationship between owners and managers of a company. Looking back in history, most companies were directed by their owners until the late 18th to early 19th century. At some point, however, the amount of capital and managerial resources needed in large and expanding companies led to the sale of equity to the public. Due to the increased size of the companies, hiring of managers to lead a company on the owner's behalf became necessary. With this, the ownership and management of companies separated.

The classic principal-agent situation is characterised by the conflicts that may result due to the differing interests of owners and managers. This was already described in the early days of larger companies: Adam Smith pointed out even in 1776 that managers do not have the same interest in promoting a firm's success as they would have if they owned the company (Smith 1776).

In agency theory solutions to these problems are recommended in the form of efficient contracts that force the agent to behave according to the owner's intention. The perspective of Jensen and Meckling (1976), who describe a company as a nexus of contracts, is often used to describe the agency problem.

This theory needs expansion, however, since the principal-agent situation no longer exists. Instead, "the owner" is usually a diverse group of shareholders, and, in addition, other stakeholders often influence the relationship or even take on the role of yet another principal. Furthermore, structures have developed between the principal and agent in the form of intermediates, especially supervisory boards, which clearly do not represent just one of the parties.

The question of whose interests the boards should serve is also vital to understanding the purpose of a supervising body, as supervision and control can be exercised in quite different ways, depending on what goals are being pursued.

2.3.2.1 Whose Interests Are Served?

Building on the above, one immediate conclusion would be that supervision must be conducted in the interest of the owners, i.e., the shareholders. After all, supervision became necessary due to the separation of ownership and management. There are, however, two other possibilities: to manage a company in the interest of the stakeholders, amongst whom the shareholders may or may not be counted; or, one could assume that the company, as a legal personality, has an interest in its own right and should therefore be managed accordingly.

Aspects in favour of the owners' interests are the fact that, initially, the supervisory committee was created to represent the owners. This situation was certainly valid until the 19th century (Drucker 1974). It could also be argued that, from a legal perspective, the owners of a company have the right to conduct their company's business the way they like. After all, anyone can do whatever he wants with his own property, as long as it conforms to the law.

Another question now arises: what interests of the owners should be pursued? As soon as there is more than one owner, one is potentially confronted with diverging interests.

This is best seen in large corporations, which can be owned by thousands of shareholders. Some of these shareholders may have bought the shares hoping that the stock price would skyrocket in the short-run (e.g., this often occurs in situations of M&A speculation) and they would be able to make a fast profit. Others may regard their shares as a long-term investment, count on the payout of dividends or may even wish to pass them on to their children. Furthermore, some people may have emotional reasons for taking a stake in a company. In the most extreme case there are as many interests as shareholders. On which of these interests should the supervising body's actions now be based? Depending on this, the perception of a board's duties varies completely.

It should also be mentioned that this question cannot be answered in a democratic way: stating that the interest of the majority is all-dominant would mean that, in the long-run, nobody would buy shares anymore. Becoming a minority shareholder would mean that the majority could do whatever it likes with one's money and the minority shareholder could not count that his interests are being considered effectively. This would imply that a public company could no longer do what it is there for, i.e., raising capital in order to act with this capital according to its purpose.

In this context, there is the view that at least one interest is shared by all owners, which is the maximization of return on capital of every single shareholder. The management should be bound to this goal. This so-called shareholder value approach was designed by Alfred Rappaport (1998) and is discussed in detail by Malik (2002).

As ultimate ownership of a company resides with the shareholders, many practitioners and researchers argue for a shareholder value perspective. Some authors argue that shareholders are the most vulnerable stakeholders, since all others can ensure their position by efficient contracting with the firm (Williamson 1984, 1985). In contrast, others argue that focusing on only one principal lowers the cost of decision-making and restricts managerial discretion.

The authors Jensen and Meckling (1976) add the reasoning of economical efficiency to this view. They assume the existence of complete contracts with all other stakeholders, thereby leaving all residual claims with the shareholders, and assume therefore that agency problems would not exist. Since these assumptions do not hold – especially due to managerial agency problems – a pure shareholder view could lead to inefficient investments; excess risk-taking in highly-levered firms might occur, as well as underinvestment in the case of debt overhang.

In this case, a shareholder plus debt provider perspective would seem to be economically efficient (Shleifer & Vishny 1997). It has become obvious, however, that numerous companies that were managed according to this concept have recently experienced difficulties.

In order for corporations to be governed efficiently in their entirety, some argue for the employment of a broader stakeholder perspective. It is important to note the greater importance of stakeholders other than finance providers in Continental Europe.

Many proponents of the shareholder value theory thereupon switched to the stakeholder approach, which was developed in 1952 by the past chairman and CEO of General Electric, Ralph Cordiner (Malik 2003, p. 37). This approach was abandoned later. According to the stakeholder approach, the centre of focus is the interests of the employees, suppliers and investors. Depending on the interpretation, shareholders could also be regarded as stakeholders.

Some researchers and journalists argue that there is no substantial difference between shareholder and stakeholder value as a consideration of important stakeholders is part of achieving a sustainable shareholder value. The key term in the discussion is "*sustainable*". In theory, assuming that the markets correctly evaluate the future cash flows of companies, including long-term aspects, there is no reason to call a shareholder value orientation short-term. But since the assumption of perfect markets does not hold, a strategy focusing on short-term stock price performance at the stock market is possible.

The stakeholder value orientation demands a stronger orientation towards serving all stakeholders and thereby laying the foundation for sustainable development. It is argued by many Europeans that American shareholder value orientation considers other stakeholders too insignificant for sustainable economic development, and therefore also for sustainable shareholder value.

2.3.2.2 A Third Approach

Both the shareholder and the stakeholder approach have a shared focus on interest groups. An alternative approach would be to regard the interest of the company itself as central. One of the first proponents of this theory was Peter Drucker who is considered to be the father of modern management. According to him, the separation of management and supervision alone expresses the idea that the company cannot and must not be managed in the interest of a specific group (Drucker 1993).

In line with Drucker's view, Malik (2002, p. 30) suggests that one should act on the assumption that the company has an interest of its own:

> Instead of focusing on the interests of the diverse interest groups (...) I suggest, that the company itself is regarded as a productive unit, that creates standard of living and wealth the more effectively, the better it functions, and as such completely independent of any specific interests of the various interest groups.

According to Malik, this approach offers the best guarantee that management will align itself with the prosperity of an organisation. He further states that if a company is conducted in the interests of the various interest groups, an organisation becomes a playing field of changing political and social powers which can potentially lead to the destabilization of the entire company.

Malik (2002) argues, therefore, against both shareholder and stakeholder approaches. Malik (2002) calls for the "strength" of the company as the top priority of corporate governance, and not interest groups, such as shareholders or stakeholders:

> Corporate capitalism, not stakeholder or shareholder capitalism. Ask the question – what is a strong company – what is a strong, viable company? The answer is: a company that has happy customers.

Malik explains a corporation's purpose as that of "creating customers" and if a corporation has customers it will, as a consequence, have happy shareholders. Instead of shareholder value or stakeholder value, he coins "customer value" as the guiding principle for entrepreneurially led companies.

With regard to the purpose of a company, Peter Drucker initially speaks about "economic performance" of the company and then that "there is only one valid definition of business purpose: to create a customer" (1993, p. 35). Malik shares this opinion and adds that customers must be satisfied with the company's services and products in order to remain customers. He further notes that customers are satisfied if, and only if, the company supplies them with more benefit than other competitors in the market. This implies that a company has to be competitive (Malik 2003, p. 36). Competitiveness, therefore, can also be understood as part of the definition of purpose, and is related to Drucker's expression of "economic performance".

This logic ultimately leads to the idea that the organisation's interest cannot be confused with that of the management. Furthermore, a company that has customers has the greatest opportunity to fulfil the interests of all groups, they "will always find investors and, ultimately, will also have satisfied shareholders and stakeholders, not as an objective, but as a consequence of successful management" (Malik 2002, p. 36).

All of these approaches have their merits and consequences. There are many good arguments in favour of placing the management under the service of the interest of the company itself and in this study, this approach is used. Again, however, it is important to stress that this study explores only one choice among several possibilities.

As described above, there is an ongoing debate as to whose interest the CEO should serve. In practice, however, CEOs usually follow the wishes of those principals with the greatest power over their future. This is typically the majority shareholders, who elect the directors, who then support or dismiss the CEO.

2.3.3 Boards of Directors Come into Play

Despite a more stakeholder-oriented perspective in Continental Europe, there is still a need to fulfil the interests of the many principals rather than those of managers. But there is a collective action problem (especially among shareholders), as costs of intervention have to be borne by the acting individual(s), while the benefits are mostly shared by all shareholders.

Boards of directors were created to overcome this issue. Indeed, the law and corporate governance regulations require such a body in companies, that shares the interests of the shareholders and to which the CEO is responsible.

It should be mentioned, however, that the establishment of a board of directors cannot directly solve the agency problem. Instead, the problem is split into two parts: an agency problem between shareholders and the board, and another between the board and management. This begs the question: Who monitors the monitors? The structure is prescribed in many countries in one form or the other and it appears to be seen as a positive structure, however, the discussion about its optimal design remains a central topic in the corporate governance debate.

Discussion of board models revolves around the question of how and in what structures boards can be used to overcome the common agency problem between top management and shareholders or more stakeholders. Because boards are required by law for all large companies in industrialized nations and legislators put such strong emphasis on them, it is useful to discuss their role and the way in which they function.

2.3.3.1 Board Roles

Depending on their underlying perspective, scholars have divergent views on the role of directors. Some see them as pawns of powerful managers (followers of the managerial hegemony approach), others are of the opinion that directors are a strong monitoring authority for the shareholders of a company (agency theory), and yet others consider them a valuable affiliate to the managers (stewardship theory). Although the duties boards assume are dependent upon local regulations, there are some responsibilities that are applicable to boards almost globally.

The multitude of board roles are condensed into the following three groups: strategy, service and control (Zahra & Pearce 1989). A few authors integrate strategy into the two other roles (Forbes & Milliken 1999). The board's involvement in ratifying and monitoring strategic decisions is thereby included in the control role. The provision of strategic advice and boundary spanning for the CEO and the management team is regarded as part of the service role. The control role is mainly based on agency theory and involves controlling the managers in order to defend shareholder interests (Fama & Jensen 1983) or stakeholder interests (Freeman 1984). The service role, derived primarily from resource dependency, calls for an attachment to the environment by establishing contacts and facilitating business matters (Pfeffer & Salancik 1978).

These roles complement, overlap, and, in some cases, contradict each other. They complement each other when, for example, the board's in-depth knowledge from its strategy role allows it to better control management in its progress towards these strategic objectives. They overlap each other, for example, in the case of a CEO change, when the board may simultaneously act in its control role (dismissing the old one), strategy role (supporting a new strategic orientation with a new CEO who requires experience), and service role (complying with a demand from external constituencies). These roles may also contradict each other, for example, when effective participation in strategic matters may impair the directors' independence and thus its control role.

It is interesting to note that priorities in terms of board roles can change during the cycle of an organisation's life (Minichilli & Hansen 2004). Boards of an early venture may place a different emphasis on their roles than boards of a declining company. The emphasis may also differ depending on firm performance and profitability.

2.3.3.2 From Individual Board Characteristics to Hilb's Integrated Approach

Most board models discuss board structures, composition, remuneration or processes. Only some of them try to integrate these issues (Hilb 2002a, b). Various aspects of board characteristics are described below and then followed by an introduction to Hilb's integrated corporate governance approach.

Board Structure

There are many kinds of board structures. The biggest difference between these various forms is that some boards have a one-tier and others a two-tier structure.

One-tier boards combine shareholder representatives and the top management team on one board. The board, therefore, fulfils the roles of adviser, decision maker and monitor as one group. Since conflicts of interest are sure to evolve between these functions, committees are set up to focus on certain functions, e.g., executive committees for decision-making (or at least for decision preparation), advisory committees for specific aspects such as technological specialties, compensation committees, and audit committees. Nevertheless, within the entire board these functions overlap although it is sometimes difficult, or even impossible, to fulfil two tasks at the same time.

The main advantage of the one-tier board is the opportunity it gives of having shareholder representatives, independent outsiders and the TMT on one board, which can improve communication between them.

It also allows, in principle, the combination of the roles of CEO and chairman. This can ease decision-making and creates the possibility of having one responsible person at the top of the company rather than two. Although such a concentration of power in one person is often criticised as resulting in too little board control, it can be helpful for fast decision-making.

There are various disadvantages associated with CEO duality. Based on the agency theory, CEO duality is associated with a much lower monitoring efficiency since, in his or her simultaneous function as chairperson, the CEO can effectively control the board by, for example, setting the board agenda or influencing the succession of directors and executives (Pearce & Zahra 1991). CEO duality may thus lead to a lack of checks and balances. Furthermore, when combining the two positions, firms may also have lower information processing capabilities, particularly in complex issues such as international business, which is why international companies are likely to separate the two jobs (Sanders & Carpenter 1998). While there is limited empirical support for the superiority of separated leadership structures (Dalton et al. 1998), there seems to be agreement that CEO duality should be avoided.

In contrast, two-tier boards separate board functions more strictly. While the management board is committed to running the business and to preparing strategic decisions, the supervisory board focuses on approving or denying such proposals, on monitoring management, and on the hire, dismissal and compensation of the TMT. This allows for a greater focus on tasks with less conflict of interests. It does, however, put the supervisory directors in a less strategic role with potentially less communication with the TMT.

Although these two board structures are superficially very different, they work in very similar ways: the appointment of committees in the one-tier system substitutes the task division of the two-tier structure, shareholder representatives often have a speaker or even appoint the chairman of one-tier boards, supervisory boards engage in direct discussions with management, and meeting frequency has always been similar in both structures. Furthermore, both structures have developed towards having four to five committees, in particular for auditing and remuneration.

These days, the audit committee is crucial. Large companies have become increasingly complex and committee members are required to take on even more responsibility. For this reason, authors call not only for educated directors but also for their strong personal commitment (Bender & Vater 2004).

In the past, many companies had an executive committee that was used as a substitute for the full board when immediate actions were required or as a preparatory body for proposals prior to disclosure to the full board (Kesner 1988). The rising number of committees made Kesner (1988) conclude that much of the board's work is actually done by board committees. Establishing special board committees has several advantages. Committees break down task complexity for directors (Kesner 1988, Bilimoria & Piderit 1994) and through the division of labour, each task can be handled in much more detail and directors are able to become experts in their assigned tasks. The smaller group size also allows for better group dynamics with less coordination costs. Lastly, committees allow for certain functions (such as deciding on remuneration) to be performed by independent outside members only.

Nevertheless, there are also arguments against committees. Foremost, there are concerns that committees create two classes of directors, despite the board members being equally responsible. Furthermore, specialist directors on the committees may not have all the relevant information on the issues facing the firm. Empirical research on the performance impact of board committees is still limited. Klein (1998) found that, overall, board composition is unrelated to firm performance but that the percentage of inside directors on finance and accounting committees positively impacts firm performance. Thus, on the whole, committees are considered beneficial to aboard in fulfilling its control role.

Board Composition

Board composition has been the focus of a great deal of research, albeit with contradictory findings. Important elements of composition are board size, insider-outsider ratio, diversity, and interlocks.

Among the most analyzed variables is board size. Large boards are associated with both advantages and disadvantages (Dalton, Daily, Johnson & Ellstrand 1999). The advantages of large boards are mostly based on arguments from the resource dependency perspective. Having more directors increases the number of links with the external environment. Large boards are also favoured in light of the stewardship perspective, since a larger board can draw upon a larger pool of expertise and experience, as well as possessing higher cognitive processing capabilities. There are, however, significant disadvantages associated with large boards. From an agency theory perspective, larger boards tend to be ineffective monitors because individual directors can hide behind the mass.

Large boards may also complicate decision making processes. While empirical evidence is ambiguous (Dalton et al. 1999), medium-sized boards appear ideal, as they benefit from a significant pool of expertise and external links, while not suffering from excessive coordination and communication costs.

Furthermore, according to the agency perspective, board independence is considered a crucial characteristic. While there are varying attempts to measure independence objectively, most research uses the inside-outside board member ratio as a proxy. A large number of outsiders is seen as advantageous for boards with regard to fulfilment of their monitoring role. Inside directors' careers are directly linked to the chief executive. They could therefore be cautious in objecting to the CEO's projects. A large number of outsiders can also bring disadvantages however. Unlike full-time officers of the firm, the part-time outside members typically know less about the organisation's businesses (Carpenter & Westphal 2001). Moreover, outside directors may divide their resources between several other organisations or positions. This limits the board's involvement and contribution to all three roles of service, strategy, and control. While intuitively appealing, there is limited empirical support for the superiority, in terms of performance, of outsider-dominated boards (Dalton et al. 1998). Nevertheless, overall, there appears to be agreement that boards, at least in their control function in bodies such as the audit committee, should be dominated by outside directors.

Furthermore, recent discussions on board composition focus on board diversity (Milliken & Martins 1996). On the one hand, it increases the level and diversity of resources and perspectives available to a group. On the other, it is associated with higher levels of conflict, lower levels of integration, and interaction difficulties. Boards in particular may fall prey to these problems as they meet infrequently and do not work together closely. The most commonly researched variables of diversity include tenure (Vafeas 2003), age, educational and functional background (Golden & Zajac 2001), gender (Hyland & Marcellino 2002), and nationality (e.g., Ruigrok, Peck & Van del' Linde 2004). Overall, this research concludes that the influence of heterogeneity is not simple and direct, but rather complex.

Another stream of board composition research focuses on interlocking directorates, denoting situations where one director is simultaneously a member of the board or TMT of another company. Again, there are both advantages and disadvantages associated with this situation (Mizruchi 1996). The benefits of interlocks are advocated mostly by the resource dependence perspective, which contends that firms may enjoy benefits of collusion, cooptation, lower transaction costs, access to information, and learning opportunities for corporate leaders (Keller 2003). Interlocks may also help to diffuse management practices. In terms of disadvantages, Keller (2003) posits that at the societal level, shortcomings include accumulation of social power, anti-competitive misuse, and inefficient resource allocation. At the firm level, they include limited board monitoring, conflicts of interest, and lack of directors' time. The effect of interlocks is unclear however. While much of the literature focuses on the number of boards a director is sitting on concurrently, it has been suggested that the nature of the ties is more important. Carpenter and Westphal (2001), for example, have found that if a director sits on several boards, the degree to which their respective strategies are related has a significant impact on the director's involvement in a given firm's strategy.

Board Processes

Since the influence of boards with regard to the overall performance of an organisation is complex (Forbes & Milliken 1999), several authors deem it vital to understand the inner workings of a board (Roberts et al. 2005). It has also been suggested that matters surrounding the inner workings are significant (Lawrence 1997).

This (including comes under the term "board processes" and includes "characteristics of boards" and "firm performance". There is, however, no clear definition of this concept of "board processes", though it may include easily observed aspects such as meeting frequency, working style, and information flow, or more complex issues such as cohesion, power, and agenda-setting (e.g., Finkelstein & Mooney 2003).

It is widely assumed that board structure and composition determine the board's ability to fulfil a certain role. Whether the board actually fulfils this role, however, is determined by board processes (Roberts et al. 2005). It is not enough that capable and knowledgeable directors sit on a board; they must actively use their knowledge and skills, and combine their experience and expertise in constructive ways (Forbes & Milliken 1999).

Board processes have still not been explored widely, mainly because the task of observing board processes is a very difficult one. Macus (2003) was the first author to integrate interaction into a theoretical model for boards, and to test his model using a case study. He also used a dynamic method, being the first to integrate changes over time in his model in terms of structures, compositions and demands on directors. This represents a significant advance from more static models which are unable to explain several famous corporate crises occurring in companies whose boards had been praised for their ideal composition a few years earlier. Macus (2003) cites the Enron scandal, which involved a board that complied with all of the best governance standards, but which was not able to catch up with new developments in the company, in particular, with new complex financial vehicles.

Hermalin and Weisbach (2001) have also developed a dynamic model, which views the activities of a board as dependent on the power of the CEO and the length of time the CEO has been in office. This is based on the idea that long-term CEOs have demonstrated their abilities and have had more influence on the nomination and re-appointment of the current directors.

Hilb's Integrated Corporate Governance Perspective

Integrated Board Management Preconditions

A board's duties and functions are controlled by various jurisdictions. Swiss civil law endows the body which supervises with the responsibility of leading the firm and the following duties: control and planning of finances, decision making regarding organisational structure, responsibility for structure and conduction of accounts, overseeing top management, electing executive management, overseeing the meeting of shareholders and the annual report and, lastly, reporting to the law in the case of insolvency or excess debt (Swiss civil law, OR716a1).

This is discussed further in the following chapter. In terms of boards and corporate governance, many countries have created standards for best practice which go well with regulations already in operation. This resulted from cases of bad management when function fulfilment, in terms of the board's supervision and shareholder-representation, was questionable.

As Hilb contends, no single approach to board management works in every social or economic circumstance. In spite of this, in the last few decades, American corporate governance approaches have become dominant as a style of board management because of the globalisation of capital markets which are largely dominated by America. These styles are often unsuitable to the various contexts of transnational firms (Hilb 2004, p. 3).

According to Pic (1997), unprofessionalism in choice and composition of boards, a board's deficiency in strategic vision, entrepreneurialism, compensation and board development, as well as insufficient assessment of the performance of supervisory and management boards, is the reason for the majority of failures in transnational firms (Hilb 2004).

Previously, the qualities of a board were examined mostly in isolation. But the various elements of a board of directors are amalgamated in Hilb's perspective. In his book, "Transnational Management of Human Resources", Hilb (2002a) proposes that for international firms there are three key aspects in an integrated corporate governance approach:

The *first aspect* deals with the preconditions of an integrated board management in terms of the best possible board composition, an effective board structure, a stakeholder-oriented vision, and a culture which is productive and open (see Fig. 2.1).

Effective board management through four integrated stages constitutes the *second aspect* of the approach, which includes board composition based on vision, board compensation, individuals' development, and feedback inside the team.

Lastly, the intermittent assessment of the board's progress constitutes the *third aspect* of the approach. This is illustrated by the pointers in Fig. 2.1.

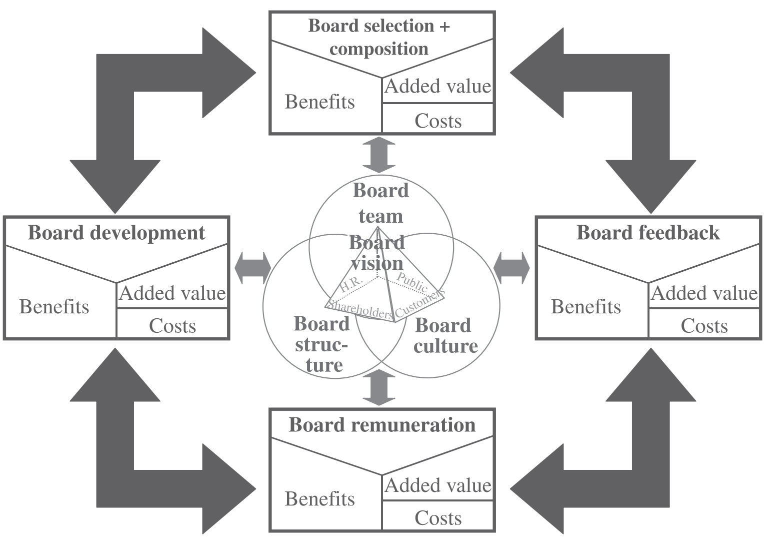

Fig. 2.1 Hilb's approach to integrated board management

In Sections 4.1.2.4 and 4.2.3.4, this approach forms the foundation of the corporate governance examination of both case studies in the empirical section.

2.3.4 The Swiss Board System

The board system in Switzerland differs, for example, from the system of a unitary board in the American-British business world or the strict dual board system of Germany. Below follows a discussion on the particularities of the Swiss board system and the non-transferable and inalienable responsibilities assigned to the board.

Swiss Board System

There are three sources of legal provisions that are relevant to a Swiss joint stock corporation's board: federal law, articles of association, and corporate bylaws. In addition, Swiss quoted firms need to comply with Swiss stock exchange regulations (SWX 2002) or provide an explanation for their non-compliance. They may also decide to comply with the Best Practice Corporate Governance Code of Switzerland (Economiesuisse 2002) as a non-binding recommendation for Swiss public corporations. This regulation and code focus mainly on additional disclosures and are detailed here.

Switzerland's Code of Obligations leaves companies quite a bit of discretion in designing and optimizing their top structures (Biland 1989, p. 18). The law requires firms to have a minimum of one board, consisting of at least a president and a secretary (Art. 712OR). In principle, the board is in charge and accountable for all tasks that, according to law or the articles of association, involve the corporation's day-to-day business dealings and do not fall under the responsibility of the general assembly (Art. 716,1OR). The directors can, however, delegate duties to the "delegate of the board" or to other "directors". In the case of delegation, the board is responsible for the "business of the firm, to the extent that is it does not delegate it to management" (Art. 716 2OR).

> (...) the governing board, according to Swiss Law, has ultimate responsibility ("Oberleitung"). This means that the board normally runs the business.
>
> In practice, of course, that isn't very realistic; in a large company a board of 15 people can't run the business. As a rule, the board delegates the management function to the so-called "delegate of the board". If this is the case, then this delegate has a relatively strong legal authority and the Swiss type of governing board has a reduced responsibility, similar to a German supervisory board. In this case, the governing board has re-assigned its responsibility. Though it never goes so far as in Germany where a management board can buy a company for 10 billion without consulting the governing board.
>
> This isn't the case in Switzerland. Here the board not only decides on the nominations for the director generals but is also involved in anything that concerns the management as well as important strategies and acquisitions.
>
> Maucher, during interview

As such, Swiss firms can choose from a continuum of systems, depending on the extent and modus of delegation. Three models stand out (Bleicher 1989, Forstmoser 1996). The first model is based on the premise that the management of the firm is being handled by inside board members and the supervision is handled mostly by outside board members, the American and British one-tier/unitary board system can thus be realised. The second model depends on the board delegating the majority of the firm's management to a non-board member CEO. In this way, the German dual board system with strict separation of management and supervision is emulated. The last model is based on the delegate of the board assuming much of the power and authority, through holding the chairperson position simultaneously. This model conforms closely to the French system of a President Directeur General. These three models, however, can only be implemented to the extent that the board retains the non-transferable tasks of ultimate direction and the right to withdraw its delegation at any time.

In practice, most listed companies in Switzerland adopt a two-tier board structure, which is more similar to the German model than the American-British model of a unitary board. The first tier, the board of directors, is comprised mostly of non-executive directors and is responsible for supervising management and shaping the company's long-term strategy (Biland & Zahn 1998). The second tier, the management board (sometimes referred to as the executive committee), consists only of managers and is in command of daily operations. Swiss firms are often arranged so that the CEO is the delegate and vice chairperson of the board, complemented by an external board chairperson (Forstmoser 1996).

Non-transferable Responsibilities

As indicated, the board has certain responsibility that it must not delegate to another body of the firm. Art. 716a OR lists these non-transferable and inalienable responsibilities, the foremost of which is determining the company's ultimate direction. This is generally understood to be limited to fundamental decisions and not daily operative management (Forstmoser 1996).

Six activities constitute this ultimate direction (Forstmoser 1996, Böckli 2004). The first and most important activity is the development of the firm's strategic objectives. In addition, the board selects the means to achieve these goals. Moreover, the board prioritises the use of scarce financial resources (Böckli 1994) and balances the objectives and means throughout the peaks and troughs of the business cycle (Böckli 2004). Furthermore, the board must give the management the necessary directions as to how to achieve targets and use the means. The board is then responsible for monitoring the firm's various bodies for achievement of these objectives. Lastly, the board must be ready to intervene in times of crisis (Böckli 2004). In short, the board is responsible for corporate strategy (Böckli 2004).

There are a number of other non-transferable aspects such as the shaping of the organisational structure and responsibility for financial management and reporting (Art. 716a OR). These other duties can be considered part of the realisation of the ultimate direction (Forstmoser 1996). Moreover, boards must always comply with the duty of care and equal treatment and the fiduciary duty (Böckli 2004).

Views differ as to the extent to which Swiss boards are active. Some researchers posit that corporate policy and long-term planning represent the core of board work in Switzerland (Buchmann 1976). Others maintain that, as it is in other countries, the reality of board work differs significantly from the highly strategy-oriented one prescribed in the legal documents and bylaws, which suggests that boards retreat in a controlling and rubber-stamping role (Biland 1989).

2.3.5 Theoretically Reasonable Board Stances

In the next section, a range of theoretically reasonable board stances are introduced, with the aim exploring these stances in the context of M&A in the empirical part of this study.

According to the law, the board of directors has a duty to conduct the business of the company "with due diligence". As mentioned above, however, the law entitles the board to delegate this duty to other parties. Nevertheless, it is important to note that the responsibility for the direction of the business remains with the board of directors in spite of delegation. If the board does not fulfil its duties, with consequently implied losses for the corporation, the law claims that the board is liable to the corporation, the shareholders and the creditors.

The delegation of the management function has, increasingly, pushed the board of directors into a passive role. The responsibility for the company, however, has not been affected. Spectacular lawsuits of shareholders against directors and management in the US have shown that boards of directors are, increasingly, being held accountable for their management's actions. Considering these developments, a broader interpretation of the responsibility of the board of directors is necessary.

Theoretically Reasonable Board Stances

The regulator of board duties has produced several different interpretations as to how a board should be organised. Accordingly, several quite different board models are conceivable, each of them implying different activities and characteristics of the board of directors. These can co-exist and overlap. Building on Puempin (1990), the following board stances are possible.

The Representative Board

Particularly in public companies with strong management, the board of directors has a very limited influence on the business operations. The board functions more like a supervisory board as designed by German law. To underpin the prestige of a company, these boards are often key representatives of important political groups, e.g., members of parliaments, association representatives or former top-ranking officials.

The representative board of directors only meets a few times a year. During the meetings, several standard agenda items are discussed, such as the company results or budgets. The board's most important duty is that of exercising its control function. Participation in the creation of company policy or other entrepreneurial activities is hardly expected in this model.

The Knowledge Board

In this model, the board of directors is normally presided over by a person who is also an active member of the executive board. In addition, the board is supplemented with several experts who function as specialists in specific areas: lawyers are the most common, who take charge of legal issues; in technically oriented companies, there are specialists from corresponding areas of technology; and finally, auditors serve as specialists in areas such as financial accounting and auditing on the boards of directors.

It is crucial in this model that board focus is not on the overall firm strategy and business development, which are sporadically discussed at best, but rather the operational management. The chief executive is the driving force in defining the strategy and will do this at his sole discretion.

The board members therefore contribute with their specific knowledge on matters: the lawyer will be asked for legal advice, the natural scientist for advice on technical issues, the auditor for questions about accounting and so on. Matters necessitating referral are principally solved on an individual basis and, in general, they are not discussed at the board's official meetings. Furthermore, the knowledge board assumes, to a certain degree, a control function, but this is not its primary role.

The knowledge board model is used in many medium-sized firms, but also in bigger companies. It usually consists of a larger number of board members and the board meetings are conducted in a very formal way.

The Entrepreneurial Board of Directors

An entrepreneurial board is one which includes entrepreneurial members. Building on Maucher (2007), entrepreneurs, as opposed to managers, are individuals whose objective is to innovate and create rather than supervise and create routines. Where the manager predicts and plans for the short-term, the entrepreneur uses her imagination and vision for the future and looks to the long-term. A manager makes decisions based on rational evaluation of pros and cons where an entrepreneur counts on his intuition and creative interpretation of the information in difficult situations; in this sense he has the personality of a leader.

In terms of stance, the entrepreneurial board model[5] not only benefits from specialists' contributions and fulfils its control function, but the top management expects an active participation in shaping the company. In the legal sense, the board of directors should deal with the essential issues that affect the existence of the company. In this capacity, the design of company policy and even important business activities belong to the board's responsibilities. The entrepreneurial board typically consists of personalities who are elected due to their experience as entrepreneurs and managers. This kind of board of directors has recently gained popularity and is often found in successful companies.

The Active Board of Directors

This model comes closest to that demarcated by the law. Board members fulfil tasks related to both operational management and business operations simultaneously. Thus, the board of directors and management are, to a large extent, identical. Typical

[5] This model corresponds most closely to Hilb's Corporate Glocalpreneurship Approach (Hilb 2002a)

examples of this model can be found in many small and medium-sized family enterprises, where the entrepreneur is president as well as delegate of the board of directors.

Other Types of Boards of Directors

For the sake of completeness, it should also be mentioned that in particular situations other types of board models are, in principle, possible. In Switzerland, for instance, according to Art. 711 Abs. 2 OR, the majority of the board of directors must consist of Swiss citizens. One would expect that some Swiss companies with foreign dominated capital are likely to elect board members solely on the basis of their Swiss citizenship, despite the fact that an international board of directors may be more appropriate. Another possible model is a board of directors with only one person, so-called "letterbox companies", which operate only pro forma.

2.3.6 Conclusion Corporate Governance Literature Review

Corporate governance was created by lawyers looking to establish responsibility and accountability in the case of failure. This explains why corporate governance literature did not, at the time, focus enough on topics directly related to success. The fact that approaches are becoming dynamic may help to turn research towards constructing tools for success and analysing the interplay between board and management at specific moments in the strategic process, such as M&A.

2.4 Gaps in Literature

With regard to M&A literature, acquisition success factors are known. In spite of this, the majority of acquisitions fail and although this has a tremendously negative impact, and there is a vast amount of academic and practical research on M&A, there are still no adequate theories to explain this phenomenon. Furthermore, existing M&A research focuses primarily on management and the CEO. To date, research has not seriously considered the role of boards of directors in the acquisition process.

Corporate governance aims to discover what constitutes fair regulation of the power balance between a company's board and management. While corporate governance defines the roles of boards and recommends ways to actively animate them, it does not analyse their role in the face of a decisive kind of event such as M&A. This gap in the literature is reflected in the codes of corporate governance where there is no provision for dealing with acquisitions.

2.5 Research Questions

This study addresses these gaps. As illustrated, although acquisition success factors are established, most acquisitions fail. Despite much academic and practical research on M&A, to date, no theories exist to adequately explain this. An approach is clearly needed that takes into account the underlying or more fundamental conditions that affect M&A success likelihood. This "environment" such as the company's orientation, the board-management structure, its functions, power relations and interactions, is obviously not conducive to the fulfilment of the known success factors. This, it is proposed, is the source of acquisition failure.

In order to understand this environment, Peter Drucker's acquisition principles are used to study board management interaction in two in-depth, contrasting case studies. In this way, the conditions for the most productive environment are revealed.

Based on these considerations and to address how boards of directors contribute more effectively in order to achieve better acquisition results, the following research questions will be investigated:

1. How can the board of directors create an environment that enables greater fulfilment of the M&A success factors?
2. How can the board of directors govern the board-management relationship during the acquisition process in order to enhance acquisition success likelihood?

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