Corso di Laurea specialistica in Economia e Gestione delle Aziende
International Management

Tesi di Laurea

The internationalization of Italian companies: a focus on the M&A process

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Anno Accademico
2013 / 2014

INTRODUCTION

The idea of this thesis born when, reading articles on newspapers, blogs and books, I found the interest link between internationalization and M&A, two topics that have always been of primer interest for me.

Internationalization, is an over-used word nowadays, that everybody talks about without having in mind a clear idea of what it is and which are the difficulties linked to this interesting word.

M&A is a fantastic instrument that can give to companies the extraordinary chance of creating a super-power entity that can leverage the know how, competences, ideas of two companies, together, even if it is a very complex and extremely challenging process.

In a world where change and challenges are every day stronger and faster, companies have to find a way to become more flexible, yet stronger too, to continue acting as leader in the market. Along the dissertation, I will try to give an overview of those two topics, without expecting to cover all the characteristics and shades that are proper of those phenomenon, but giving the basic instruments to appreciate more in detail those interest concepts.

In the first chapter, i will point the attention on the broad concept of internationalization, trying to give the basic definitions of the different solutions between which the firm can chose to go abroad (export, partnership, joint venture, merger or acquisition), and the consequences that each of those channels have on the activity.

In the second chapter i will deeply focus on the process of merger and acquisition, the strategic logic behind it, why companies choose to merger or acquire another. I will briefly talk about the reasons why sometimes the processes fail, even if they have all the characteristics to succeed, and which could be the possible solution to this problem.

In the third chapter, i describe the process of merger and acquisition from the accounting point of view, both under the international accounting standard (in particular, analyzing IFRS3, IFRS 10 and IAS 27), and the italian ones, considering that i am studying the implications that those processes can have in the italian context (in particular, OIC 4 and 17).
Then, in the last chapter, i will generally present the Campari Group case, after an overview of the merger and acquisition market in Italy, in order to give a tangible example of what presented in the previous chapters and underline the huge potentiality that the right acquisition strategy can have.
The aim is to give an overview of the market of merger and acquisition in Italy, the instruments that italian firms can use to go abroad and exploit their key feature that is know-how and excellence manufacturing capabilities.
Network is a way to generate profit, share competences and know-how, and enter new markets as well, in a more soft way than entering with merger or acquisition.

CHAPTER 1

SUMMARY: 1.1 Introduction; 1.2 Internatioalization process; 1.3 Export: what? why?; 1.3.1 Direct export: characteristics, goal, advantages and disadvantages; 1.3.2 Indirect export: characteristics, goal, advantages and disadvantages; 1.4 FDI: what? why?; 1.5 Partnership and joint venture: what? why?

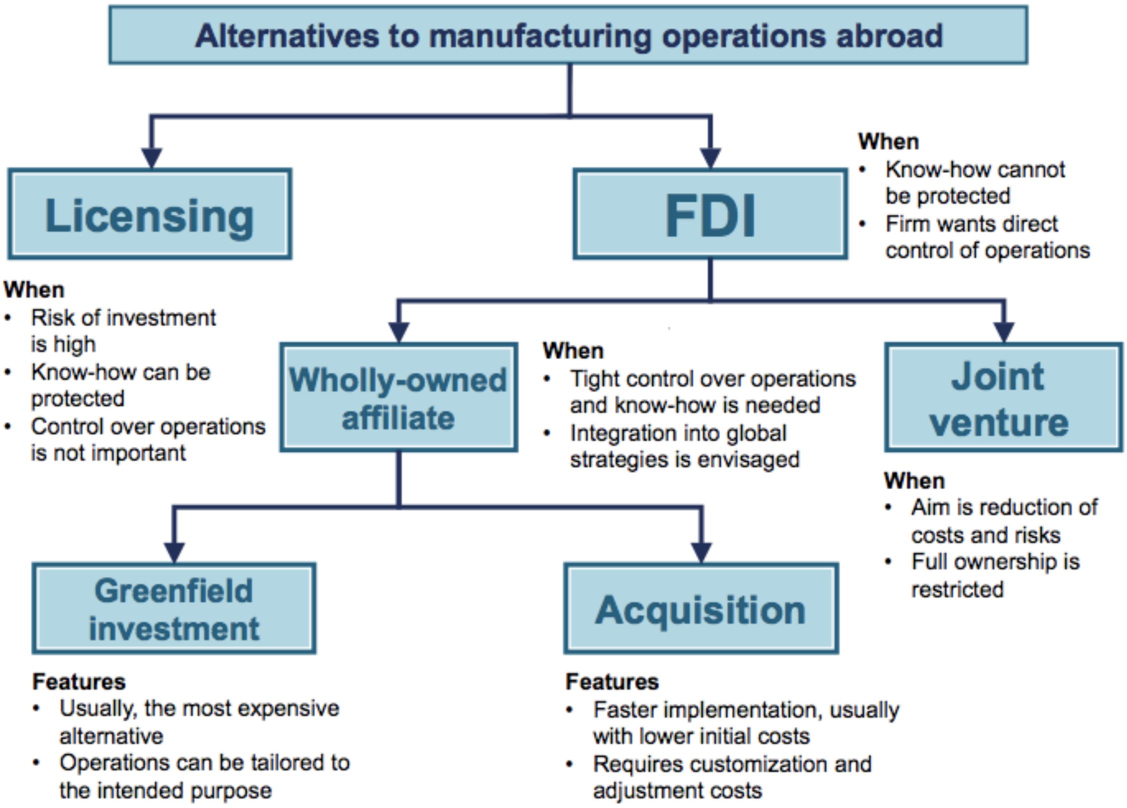
1.1 Introduction

The process of internationalization of italian companies during the last years has been driven by mergers and acquisitions, not only from foreign companies acquiring italian ones, but also the opposite.

In this section I am going to analyse the reasons behind the choice of using m&a process to go abroad compared to other alternatives, the implications and the trends of this kind of activity. To make this possible, it is necessary to early present the topic of firm internationalization and the tools that can be used by a company, depending the goal it wants to achieve.

Earlier models that helped explain the growth and pattern on international trade are less applicable today because of changes in the competitive environment, but are anyway considered and discussed in this section due to the importance and stimulus that they give to the future literature.[1]

[1] James P. Neelankavil and Anoop Rai, M.E., " Basics of international business", Chapter 5 p.125 and following



1.2 Internationalization Processes

"Why do some choose to incur in extra expenses of establishing production facilities abroad? [2] *Direct investments will be chosen instead, or as adjunct of, trade only to the extent that the location itself confers a substantial advantage to the company. This advantage could result from the usual elements of competitive advantage as reflected in lower production cost."*[3]

[2] http://ec.europa.eu/enterprise/policies/sme/market-access/internationalisation/index_en.htm

[3] National bureau of economic research "Foreign direct investment, new perspectives on foreign direct investments ",Chapter 2 p. 40

The context of globalization has brought companies to face an increasing number of new challenges, that brought firms into a "new reality":[4] rising of demand from foreign customers, treats due to more competitors, increasing possibilities to enter into new markets, increasing possibility of improving knowledge through the response to challenges and new technologies, decreasing in costs (relative only to some sector), and so forth.

The reasons why a company takes into consideration the hypothesis of going abroad are many and different, and come from the internal environment or from the external one.[5]

Just to mention few of them:

- the domestic market is overstocked and the company looks for new customers;
- new market, new opportunity not only to sell the product/service, but also to learn new tools and improve capabilities (learning processes);
- new markets are seen as potentially profitable for the good conditions within them (i.e., law taxation cost, better IT system, less bureaucracy...);
- the company wants to improve its profits and expands the business in order to achieve this goal;
- falling barriers of entry.

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[4] "Theories of international trade, foreign direct investment and firm internationalization: a critique", that refers to Lazer, "Changing Dimension In International Marketing Management", 1993

[5] Carioli M., Fratocchi L., "Nuove tendenze nelle strategie di internazionalizzazione delle imprese minori", 2000, FrancoAngeli editor

	Start international presence	Develop international presence
Import	• Best procurement conditions	• Best procurement conditions
Export	• New market • Exploit competitive opportunities • Learning processes	• New markets • Development of strategic synergies
Joint Venture	• New markets • Risk management • Learning processes	• New markets • Exploitation of new opportunities • Strategic and organizational flexibility • Competences development
Foreign Direct Investment	• Enhancement of competitive position • Exploitation of localization advantages	• Enhancement of competitive position • Exploitation of localization advantages • International development

When the company decides to internationalize, it has to define whether going abroad with up-stream activities (the so called delocalization, outsourcing) or down-stream activities (internationalization in the closest version): in doing this, the final decision has to take into account different aspects like costs (linked with work, building, competition already present into the market), consumers needs, suppliers knowledge and expertise, government restrictions, taxation, regulations and many other.

The difference between delocalize and internationalize lies in the final aim that the company wants to achieve: if the focus is on cost reduction, especially the manufacturing costs (but not limited to those), we talk about delocalization that is the process by which the company goes abroad for the production of part/total product because in other countries finds better conditions (i.e., european companies delocalizing in China or east europe), whereas the final market remains the domestic one (here attention is pointed on cost reduction, and the final product is delivered into the main market, that does not change, does not become international but remain local).

When the focus is on the final market, and so the company decides to go abroad to increase its presence also at international level, gaining market share in a foreign context, in this case we talk about internationalization (here we can clearly distinguish a more structured strategy to enter the new market, and the willingness of company to be in direct contact with it).

The point for the company to define the strategy for internationalization is the analysis of the many variables that could affect the success or failure of the process, in order to configure the most effective plan of action.[6]

First of all, the main decision is about where to go, the market or in general the geographical area of interest. The localization of where to invest is, of course, crucial.

At this stage the company considers especially the macroeconomics variables that influence the business: rate of GDP growth, inflation rate, trend of internal commerce (exchange rate with foreign countries to understand the openness of the State), are all important and linked variables that let the company understand which could be the most profitable country to enter in (the growth in developing countries is driven by those positive factors, that imply high growth of average pro-capite richness and desire of consumers to buy new items).

Another useful character that could be used to discuss the internationalization strategy are the flow of foreign direct investments that tell how much a country is able to attract funds, for a variety of reasons, indication the trends in international commerce.

FDIs give information about how a country is considered virtuous and able to attract a considerable amount of foreign investments that can start a positive

[6] Jones, Coviello, Article on the Journal of International Business Studies (2005) 36, 284–303

cycle of growth, which is supposed to bring positive returns for companies working within, as well.

In addition to macroeconomic variables, the company considers also other important aspects of the target country that could somehow affect the positive return, cash flow and activities prosecution, such as taxation (low tax rate can be an incentive for companies not only in the manufacturing but also in service field, as confirm the increasing presence of foreign companies establishing a branch in Ireland, for example, like Google), bureaucracy (a lean bureaucracy facilitate the exchange of information between company and governance, as well as between companies interacting, and made it easier the procedures to start a business), the presence/recognition of international trade agreements and the beginning of liberalization process (both fiscal and juridical).

After this initial step in which a target country has been identified, another important variable is the degree of development of the target segment to avoid the collocation of a product/service that is not perceived as relevant by consumers.

Because it could be very difficult to analyze a country far from the domestic one, usually, at the beginning of the internationalization's process, the company chooses to consider that places that are more similar and less geographically distant, to better manage differences and starting the process of identification of important variables (the ones listed above): it is easier to start with a country that has proximity in location, culture, and structure, and then, after having acquired a sufficient knowledge on how to manage the process of internationalization, going further and enter into more complex and different countries.

A gradual acquisition, integration and use of knowledge about foreign markets and operations, and the incrementally increasing commitments to foreign markets, allow the company to maximize its presence abroad (e.g., for an italian firm is easier to enter before into an european market, like France or Spain, learn how to handle the internationalization process in a different context and culture, and then, after have improved the necessary capabilities, try to enter in more diverse markets such as Russia or Brazil) especially to avoid the so called shock of internationalize into a nation that is too different to be managed.[7]

Generally speaking, once the company has determined where to internationalize, it has to choose how to enter into a new market, and this can be done in different ways, depending on the financial capacity, risk attitude, expectations, knowledge, and so forth. We can identify those processes of internationalization, each of which has different implications for the company:

- direct or indirect export;
- foreign direct investments (FDE);
- partnership or joint venture;
- M&A

The following table gives an overview of the external and internal factors that influences the choice of how to go abroad. The more the goal is linked with key strategic reasons, the more control has to be kept centralized, thus direct approach to the foreign market will be required.

If, by contrast, the aim is to expand the market through, for example, the sale of the product or service, it could be enough to have a delegated figure that administrates the normal management tools in belief of the company, or also a wholesaler.

It is not only a matter of cost saving: especially in recent years many companies returned back to the home country because the trade off between costs saved and benefits achieved was not that high anymore to justify an

[7] Johanson J., Vahlne J. E., "The internationalization process of the firm-a model of knowledge development and increasing foreign market commitmen", Journal of International Business Studies, vol. 8, number 1,spring-summer, Palgrave Macmillan Journals ,1977

investment abroad to the detriment of quality (this is happening especially in the clothing and furniture sectors). If in the past one of the major reasons why a company chose to go abroad was the attainment of economies of scale or costs saving, nowadays the major reasons are different and lie in the proximity with the final market to better serve the demand, the reduction of time-to-market, the local knowledge of how the market works.

If a company delocalized mainly to shrink costs (e.g., labour cost, raw materials, operative costs like rental of buildings and machinery), in many cases during the years those potential benefits that before were usual in market such as China, Eastern Europe, are no more so consistent to justify the delocalization, because Governments are balancing costs on the average of developed nations, salaries are increasing, set up costs are increasing as well, and firms do not have anymore the huge advantage that they had before (in many situations, costs are becoming equal, so if the reason for delocalization was cost saving, it is no more convenient).

We saw, for example, a return "in-house" of italian companies (Natuzzi, And Camicie, Prada, Ferragamo, Fiamm, just to mention a few) that choose to come back to leverage passion, competencies and handcraft knowledge of italian artisans, instead of producing in countries where labour cost was lower, against weak capacity.

Coming back to our main roadmap, the dimension of the company plays an important role, too: indeed, if the company has the sufficient extension, it can easily approach a new market with a solid background, risking but having the shoulders covered by stable basis.

Rather, if a company has small or medium dimension, it could be more challenging to open up a direct activity, even if this would be more profitable and right for the firm, because of possible negative effects on the overall stability of the company, and above all the financing costs of settle a new foreign branch.

That is why many italian firms, small and medium ones, at the beginning go abroad through a more lean channel, without entering the market with a deep stabilization (to be noted that this stable organization of the firm could not be profitable for some companies that do not reach any advantage from strong control on the foreign market and the firm, so many companies decide to export because it is the sole interest they have), and after having settled a basis, start internationalize the entire company.

Even if difficulties related to cultural, economical, financial, bureaucratic features are still present and influence the results of the internationalization policy, the process has become easier with the explosion of ICTs in business: the adoption of technology, should it be hardware or software version,has changed radically the way companies interact each other, with the market and within. Communication is faster, allowing better response to customers and suppliers necessities, better coordination and lower costs: to connect with a foreign partner, supplier or branch is made easy by technologies such as call conferences, video conferences and e-mails. The web site makes it possible to reach information about the market, or the firm itself and collect data to evaluate the best target, or product (from the customer perspective). Distances are dramatically decreased thanks to the connections settled between companies in different countries, and thus the efficiency of processes has increased allowing the firms to concentrate on key issues rather than general ones. The importance of technological advances is crucial for those firms willing to go abroad, because also the simple web site could allow to test the potential response of the market and facilitate the process of internationalization.

Those listed in the Table are factors influencing the choice of the company when it it defining if and how going abroad.

EXTERNAL FACTORS	INTERNAL FACTORS
Market features	General objectives of the internationalization strategy
Product features	Maturity of international approach and knowledge
Competition and benchmarks	Achievable synergies
Distribution channel	Human resources and competencies to enter the new market
Regulation and public incentives to international activities and exchange	Company dimension and its capacity of collecting financial resources
Environment	Organizational and individual forces pushing toward externalities

Now we focus deeper our attention on the different vehicles that lead to internationalization, in order to appreciate the differences existing, and benefits achievable. [8]

1.2.1 Export: - what?why?

Export strategy is one of the most used instrument to internationalize the company. It consist in the selling of product/service abroad, without the necessity to open a branch (it may requires to open a representative office, but not necessarily an expensive structured complex) through the presence of intermediaries (indirect export) or directly engaging a relationship with specific vendors, exploiting the presence on the market of a local figure (direct export).
It is usually the first step that companies make to enter a new market, to establish affiliates and receive the feedbacks of which develop a deeper strategy. [9]There is a business international literature that prove how FDI are

[8] Baronchelli G., "La delocalizzazione nei mercati internazionali. Dagli IDE all` off-shoring", LED Edizioni Universitarie, 2008
[9] Conconi P., Sapir A., Zanardi M., "Internationalization process of firms: from exports to FDI", January 2014, Publication of Universitè Libre de Bruxelles (ECARES)

the second step toward internationalization after exports, led by the need to acquire knowledge about local demand and supply conditions.[10]

The findings of an interesting study conduced by researchers from the Universitè Libre de Bruxelles, on a panel of belgian companies internationalizing through FDI and export, found that 99,9% of firms that started exporting to a foreign market did so without having previously invested there, so through export.

By contrast, 86,32% that started investing in a foreign market had already been exporting to that destination (similar parents have been documented for French firms by Gazaniol (2012), who found that in 95% of the cases exports precede FDI).

An important consideration is that, even if internationalization through export is relatively easy to be managed, it is necessary to create a continuous exchange of informations between the headquarter and the foreign branches (here, "branches" means only the presence abroad through a wholesaler, that presumes a physical office both operative and representative), avoiding mismatches of intents.

It is necessary therefore to set up an internal network to control the operational progresses and operating results in each geographic area.

The rapid development and constant upgrading of information technologies and linked systems allows also to small companies to go abroad thanks to export relationship controlled directly and efficiently by the form (the importance of innovation is here crucial because allows to better manage the requests from the foreign market, analyze results, better interact with

[10] Helpman E., Melitz M.J., Yeaple S.R., "Export Versus FDI with heterogeneous firms", The American Economic Review, Vol. 94 No.1, pp. 300-316, March 2004, Buckley P.J., Casson M., "The Optimal Timing of a Foreign Direct Investment" Economic Journal Vol. 9 No.361, pp. 75-87, March 1981
Conconi P., Sapir A., Zanardi M., "Internationalization process of firms: from exports to FDI", January 2014, Publication of Universitè Libre de Bruxelles (ECARES)

intermediaries or vendors, and have a more clear view of the market), and to gain visibility at international level. [11]

It is less risky than other kind of processes because does not require the settlement of a stable physical presence inside the market, instead use the already present knowledge of local representatives, vendors and distributors, to better enter the market. However, even if it requires less commitment than other kind of entry mode, it is necessary to be enough flexible to achieve the required adaptation to the market.

There are few steps the company must do before entering a market, implementing processes:

- Conduct market research to determine the needs of the market, measure the potential response of the firm, understand the possible barriers and competition;
- Size the product or service based on the customers needs and the balance with the firms`expectations, not giving all the rage of products or services but leveraging the most usable and required ones;
- Determine the size of the market;
- Create the basis for future alliances through the participation at trade shows;
- Create an efficient customer service division for the targeted market to avoid cues in customers`requests and allowing a better and faster response;
- Be regularly present on the market, at least at the beginning, to create a sense of participation with customers and suppliers, and to give the image of the involvement.

From the company`s point of view, to export is a way to leverage its competitive knowledge enlarging the boundaries of activity. It is known from

[11] Basile, R., "Export Behaviour of Italian Manufacturing Firms over the Nineties: The Role of Innovation", Research Policy, 30 (8), 1185–1201, 2001

the literature that usually companies export a product or service that they are proficient with. This imply a benefit not only form the firm`s perspective but also for the country in which the firm exports: indeed, by approaching the market with a new product, new competences are gained by the hosting institution, in term of differences between products. Besides, the growth of competition is positive for customers that can have a wider range of choice, and more competitive prices.

Companies entering in a new environment activate the process of learning by doing, that is the driver of evolution in economics.[12]

Export is the first step toward a more deep iteration in international markets, and, as first step, imply all those consequences (and many more) that influence and enhance the company`s capabilities. It is a push toward innovation, renovation process, change.

International evidence also shows that exporters help the long-term survival of firms in the economy.

This is because they enjoy faster sales and employment growth than non-exporters enabling a higher rate of survival and contributing to overall allocative efficiency in the economy. Diversification of sales across international borders spreads risk especially if demand patterns differ across borders.[13]

When the company decides to export, both directly and indirectly, it has to define the degree of control that wants to maintain in the new market. The presence of agents, at least at the beginning, that have a knowledge of the characteristics of the economic and social environment is important, thus to

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[12] WTO report, Discussion paper “why Australia needs to export”, introductory section, 2000

[13] https://www.wto.org/english/news_e/spmm_e/aust_e.pdf

Bernard, A. and Jensen, J., “Exporting and productivity”, NBER Working Paper, No.7135, National Bureau of Economic Research, Cambridge, Massachusetts, 1999

Richardson, J. David, “Why Exports Are Worth Promoting” , Institute for International Economics, Washington D.C., 1996 delegate part of power to the new “branch”. As mentioned above, new technologies made it easier to keep the control over the value chain abroad, but not all the companies have the funds necessary to implement an efficient and effective internal communication network. Competitiveness is also about this: have the right technology to allow a faster, more effective and efficient development both abroad and in-house.

Depending on the commitment that the company wants to maintain, it is possible to distinguish between direct and indirect export, on the basis of the presence or not of an intermediate between the company and the final customer.

1.2.1.1 DIRECT EXPORT: characteristics, goal, advantages and disadvantages

In direct export, the company is responsible for selling the product or service on the market (e.g., handling the market research, foreign distribution, logistics of shipment and for collecting payment), and has the full control on the overall process of distribution.

The advantages of this method are:

- the potential profits are greater because the firm eliminates intermediaries.
- greater degree of control over all aspects of the transaction.
- knowledge about who the customers are.
- the customers know who the firm is. They feel more secure in doing business directly with it.
- business trips are much more efficient and effective because the firm can meet directly with the customer responsible for selling products.
- the firm knows whom to contact if something isn't working.
- customers provide faster and more direct feedback on product and its performance in the marketplace.

- slightly better protection for trademarks, patents and copyrights.
- to present themselves as fully committed and engaged in the export process.
- development of a better understanding of the marketplace.
- As business develops in the foreign market, the firm has greater flexibility to improve or redirect marketing efforts.

The disadvantages:

- It takes more time, energy and money than the firm may be able to afford.
- It requires more "people power" to cultivate a customer base.
- Servicing the business will demand more responsibility from every level of the organization.
- the firm is accountable for whatever happens. There is no buffer zone.
- the firm may not be able to respond to customer communications as quickly as a local agent can.
- the firm has to handle all the logistics of the transaction.
- If the firm has a technological product, it must be prepared to respond to technical questions, and to provide on-site start-up training and ongoing support services.

1.2.1.2 INDIRECT EXPORT: characteristics, goal, advantages and disadvantages

Indirect exporting means selling to an intermediary, who in turn sells products either directly to customers or to importing wholesalers.[14]

The easiest method of indirect exporting is to sell to an intermediary in the same country of origin. When selling by this method, the company normally is not responsible for collecting payment from the overseas customer, nor for coordinating the shipping logistics, because those aspects are in the hands of the reseller.

There are different kinds of intermediaries that can be identified: Export Management Companies (EMCs), Export Trading Companies (ETCs), and intermediaries. The first figure acts in behalf of the company and manages the whole process of exporting products as an extension of the firm, caring out all the aspects of the transition process: identifies the market and locates customers, arranges relationships with arenas or distributors, travels overseas to meet potential customers, sets up appropriate distribution channels. While this specific company is defined to be market-driven (thus, it represents the products of different companies that are non-competing ones, aimed at the customer base they have created), the ETCs are demand-driven, so they respond to the market needs for specific commodities: in this case, the exporter company has a range of customers for whom it search products, thus if the firm wants to internationalize has to contact it to know if the offered product or service could become subject of transition. We can say that,

[14] http://www.exportea.com/en/useful/methods-of-exporting

http://onlinefx.westernunion.com/business/learning-center/import-and-export/direct-vs-indirect-exporting/

http://export.gov/basicguide/eg_main_038337.asp

http://www.hmrc.gov.uk/manuals/vexpmanual/vexp20300.htm

somehow, the first exporter company follows a push strategy, while the second one a pull strategy.
The last subject is the general “intermediary” (agent), that buys from the firm and then sells directly to the foreign market or another wholesaler. The company does not know who the final customer will be, because once the product has been sold, it is no more under its property. The main company usually is responsible for collecting payments from the foreign customers and coordinating logistic.

The advantages are:

- it is almost risk-free way to begin.
- it demands minimal involvement in the export process.
- it allows you to continue to concentrate on your domestic business.
- the company has limited liability for product marketing problems
- the company learns as it goes about international marketing.
- the company can field-test products for export potential.
- in some instances, the local agent can field technical questions and provide necessary product support.

The disadvantages are:

- profits are lower.
- lose control over your foreign sales.
- the firm very rarely knows who your customers are, and thus loses the opportunity to tailor its offerings to their evolving needs.
- the intermediary might also be offering products similar to the ones of the firm, including directly competitive products, to the same customers instead of providing exclusive representation.

- the long-term outlook and goals for export program can change rapidly, and if the company has put product in someone else's hands, it's hard to redirect efforts accordingly.

1.2.2 Foreign Direct Investments: what?why?

Consider the definition given by the OECD, Foreign Direct Investment "Is a cross-border investment by a resident entity in one economy with the objective of obtaining a lasting interest in an enterprise resident in another economy. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the direct investor on the management of the enterprise. Ownership of at least 10% of the voting power, representing the influence by the investor, is the basic criterion used". [15]

The corporation can establish the business in another country through the settlement of a new wholly-owned affiliate, acquiring a local company or forming a joint venture in the host economy. [16]

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[15] Theories of international trade, foreign direct investment and firm internationalization: a critique TAB 1 page 3

http://www.oecd-ilibrary.org/sites/factbook-2013-en/04/02/01/index.html?itemId=/content/chapter/factbook-2013-34-en

http://www.oecd.org/fr/daf/inv/statistiquesetanalysesdelinvestissement/fdibenchmarkdefinition.htm

http://www.oecd.org/investment/statistics.htm

http://www.going-global.com/articles/understanding_foreign_direct_investment.htm

[16] Theodore H. Moran, "Foreign Direct Investment", The Wiley-Blackwell Encyclopedia of Globalization, published online in Feb 2012

About trends in developing countries, the most profound effect has been seen in developing countries, where yearly foreign direct investment flows have increased from an average of less than $10 billion in the 1970's to a yearly average of less than $20 billion in the 1980's, to explode in the 1990s from $26.7billion in 1990 to $179

The extension of existing activities is positively related to the lagged sales of foreign affiliates. [17]

One consistent feature that identifies a Foreign Direct Investment is the control taken by the company that invests on the target company: the amount of shares that a multinational can own to possess a controlling interest can vary and can be as low as 10-15% (the U.S State Department considers 10% ownership suffucient for classification as FDI, while the European Union sets 15% as minimum amount of equity capital acquired by the multinational).[18]

FDI in recent years has come to play a major role in the internationalization of the business thanks to the growing liberalization of markets and regulatory framework governing investments in enterprises, changes in capital markets and changes in technology. Foreign Direct Investments provide the corporation with new markets, new marketing channels, cheaper production facilities, access to new technologies, products, skills, and financing; while form the hosting country perspective, investments are a source of new capital processes, products, organizational technologies and managerial skills.

FDIs are one way, for small and medium enterprises, to enter into foreign countries bypassing the hurdle of settling a completely new branch abroad, and gain advantage from the presence of a direct hand on the market.

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billion in 1998 and $208 billion in 1999 and now comprise a large portion of global FDI.. Driven by mergers and acquisitions and internationalization of production in a range of industries, FDI into developed countries last year rose to $636 billion, from $481 billion in 1998 (Source: UNCTAD)

http://onlinelibrary.wiley.com/doi/10.1002/9780470670590.wbeog216/full

http://amj.aom.org/content/43/3/468.short

[17] Guy V.G. Stevens, "Capital mobility and the international firm"

[18] James P.Neelankavil and Anoop Rai, M.E, " Basics of international business", Chapter 5 p. 126, Sharpe editor, 2009

Directorate for Financial and Enterprise Affairs, OECD, "Foreign direct investments for development; maximising benefits, minimising costs", OECD report, OECD publishing, 2002

Entering into a new market, especially the more close ones, through direct investments is a way to improve the knowledge about both process of internationalization and local market, and to gain "respect" form the local government.

Besides, this instrument avoids foreign government pressure for local production (indeed the manufacturing processes are kept and improved), then circumvents trade barriers, hidden and otherwise, makes the move form a national domestic export sales to a local based national sales office, and gives the capability to increase the production capacity while is an opportunity for co-production, joint venture with local partners, join marketing arrangements and so forth (those give the chance to know more about the country, improve more rapidly the adaptability of the company and the management's capacity to react to new stimulus).

Some of the basic requirements for companies considering foreign investments are:[19]

- monitor competitors activity
- global trends in the industry
- monitor how the globalization affects domestic customers
- expansion of key-clients overseas (if is required to keep an active business relationship)
- assessment of internal resources (in the foreign market)
- competitiveness (potential and effective)
- market analysis
- market expectations

[19] http://www.going-global.com/articles/understanding_foreign_direct_investment.htm

The usual process of expansion into a foreign country follows the steps from export of product, to investments into production, to end into the internationalization of activities with the settlement of a new branch. [20]

This is the basic timeline that companies proceed in order to identify, analyze, understand, test and proof the best choice for internationalize the business maximizing returns and minimizing costs, creating a continuum into the life cycle of the product taking advantage of profits generated.

Commonly, due to the commitment required in terms of management, money and time, this kind of instrument is used by big corporations that want to enlarge their spectrum of action rapidly, using the presence of a local company, without incurring the risk of failure that could be linked with a merger/acquisition or new branch, or by companies having a good level of liquidity to be invested in new activities.

Foreign direct investments are more common in that industries in whose there is not strong competition (like pharmaceutical industry), where corporations create their competitive advantage through investments in R&D, [21]that can be done at domestic and foreign level depending on the capabilities of research centers, in this way exploiting the knowledge developed in each country (in the pharmaceutical industry, typically the big multinationals invest on excellence centers for the research in order to allow them to continue their activity and create more suitable cures). By the way, foreign direct investment is a different shade of competition inside an industry.[22]

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[20] National bureau of economic research "Foreign direct investment - new perspectives on foreign direct investments", Chapter 2 p. 39

[21] National bureau of economic research "Foreign direct investment - new perspectives on foreign direct investments", Chapter 2 p. 40

[22] National bureau of economic research "Foreign direct investment - new perspectives on foreign direct investments", Chapter 2 p. 44

1.2.3 Partnership & Joint Venture: what?why?

When two or more companies get together to achieve a common goal creating a cooperative business venture (i.e., a new entity), we talk about Joint Venture. There are different types of Joint Venture, as the next table explains, and all of them have in common those aspects that I will talk about briefly.

Contractual joint ventures	Also called consortia or consortiums. They are short-to medium-term business alliances, set-up to implement time-limited projects
Equity joint ventures	Also called incorporated joint ventures. They are long-term partnerships and usually imply the creation of a new legal entity
Cooperative joint ventures	The partners are an international company and the government of a developing country; they may not need to be a separate legal person
Restructuring joint ventures	They mostly happen between MNEs in the context of their restructuring strategies. They are transitional for business take-overs

Table from UNIDO report on Patterns of Internationalization for developing countries

During the definition of the deal, dealers decide how to allocate resources, assign risks and potential returns, and delegate operational responsibilities to each member while preserving autonomy. Usually, once the project is completed, the Joint Venture is disbanded (even if it could also happen that relationship will last longer, generating a synergy that will bring results in the long term as well).

The establishment of a Joint Venture allows the firm to create a marketing or manufacturing presence abroad under the directives (and advices) of a local foreign partner (e.g., knowledge of government laws or regulations, internal markets and distribution know-how, valuable information for the firm in unfamiliar territory).

A strategic alliance is partially similar to the Joint Venture: it is an agreement between firms that want to reach a common goal, but they do not create a new entity, rather remain separated and separated and undertake an alliance. The alliance may be formed when one organization grants another one the authority to exploit technology, R&D knowledge, marketing rights and so forth.

The Joint Venture could be an ideal entry mode for those SMEs that do not have enough manpower and are not risk friendly, at all:[23] by dealing with a third company, it would have the chance to acquire skills, experience, technical knowledge of the foreign market by the local partner. The firm can significantly reduce the learning curve and share its risks with a partner that has a similar agenda.

Advantages[24] of Joint Venture could be summed up in benefits from local partner`s knowledge of host country`s competitive conditions (culture, language, law and business habits,…), costs and risks sharing, facility in entering the market. Besides, the firm gains a positive image in the eyes of local business environment. A practical example of how a Joint venture can positively affect the business, is the case of an european company willing to enter the Chinese market (notoriously, the Chinese market is hard to be entered because of restrictions on foreign activity, thus even if to have a partnership with potential local competitors is a risk, it is one of the easiest way to enter the market). To engage a relationship with a local firm helps to overpass the problems linked with political, economical and law restrictions,

[23] P. Beamish, W. Lupton, C. Nathaniel, “Managing Joint Venture”, Academy of management perspectives, pp. 75-94, May 2009

[24] C. W. Hill, “international business competing in global marketplace”, Rwin, McGrawHill, 2007

and create a more sustainable relation for both companies, without complicating the process through acquisition (that, however, could be impossible or lead to the loss of key figures that key chose to change company not undertaking the change of management leadership).

An interesting example of Joint Venture is the one presented in 2006 by Nokia and Sanyo: the telephone manufacturer wanted to enhance the CDMA technology (it is a leader in GSM technology, but the North America and Asian markets have a prevalence of CDMA tech, that thus results to be essential to enter the markets), a technology owned by Sanyo (even if it is a small firm and have a limited market share against major competitors like Samsung or LG) that at that time had weak liquidity and precarious financial situation. Both companies wanted to reinforce their position and gain market share in CDMA technology, so they chose to jointly pursue the aim.

Potentially, the joint venture may bring together competencies that leveraged can afford a 20% of market share in CDMA technology, becoming the second provider behind Samsung. The new venture will, therefore, be able to provide a comprehensive range of product offering. In terms of market perspectives, Sanyo has successful relationships with CDMA operators in the U.S. and Japan, where Nokia has long struggled to gain market share, while Nokia is stronger in big markets like India and Brazil, and its brand has the clout to boost the CDMA line in developing countries. Here, even if companies are competitors, they are both weak in the technology and they joined their resources and competences to enhance the process of development and gain market share. By forming an alliance, Nokia and Sanyo will share the high development costs of new CDMA phones, gain synergies in the range of models and access to expanded markets and achieve a meaningful market share.[25]

[25] J. M. de Caldas Lima, "Patterns of Internationalization for Developing Country Enterprises (Alliances and Joint Ventures)", prepared for UNIDO (UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION), Wien, 2008

It seems that a Joint Venture agreement or alliance is in favor of firms, more than international acquisitions. As Gray Webb (tax partner for Deloitte) said, “Joint Ventures allow companies to target the exact activity they are looking for rather than tie up capital in areas companies are not interested in”. While there are potential advantages in Joint Venture deals, there are also limitations: for the foreign investor, joint ventures may present several drawbacks compared to having full ownership of operations, first of all, as risks are shared, also profits are. Then, there can be disagreement between actors, disputes over efforts and strategies, differences in management culture and so forth. The company targeted to be the right partner, probably may become a competitor in the future, as it acts in the same field of the main (proposing) company.

Besides, another potential problem may be the possible loss of control of proprietary technology and know-how to the local partner. This risk can be minimized through a majority ownership in the joint venture, which allows for a greater control of the joint venture’s operations, or through avoiding the sharing of state-of-the- art technology; but the risk is not to be underestimated, in particular in the event that the joint venture is terminated.

Another possible shortcoming of the joint venture option for the foreign firm is that it may not be easy to integrate the joint venture’s operations into the firm’s competitive strategies at global level; this might require sacrificing profit or operating at a loss. After all, joint ventures, even with foreign majority ownership, are separate legal companies with their own management and, possibly, a significant degree of autonomy.

Problems may also arise if the partners have different strategic interests (e.g., if the foreign investor is pursuing long-term objectives to the detriment of short-term profit while the local partner expects quick returns on the invested assets;

or shifts in the balance of power between the partners may lead to conflicts over the joint venture's strategies and goals).[26]

The ability to compromise is essential and each partner has to lose part of its supremacy. There has to be commitment between firms to chase the final goal.

[26] J. M. de Caldas Lima, "Patterns of Internationalization for Developing Country Enterprises (Alliances and Joint Ventures)", section 3.1.2, prepared for UNIDO (UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION), Wien, 2008

CHAPTER 2

SUMMARY: 2.1 Introduction; 2.2 Merger, acquisition, demerger: a basic definition; 2.2.1 Merger; 2.2.2 Acquisition; 2.2.3 Demerger; 2.2.4 Merger VS acquisition; 2.3 M&A process definition; 2.3.1 Horizontal merger; 2.3.2 Vertical merger; 2.3.3 Congomerates; 2.4 Anatomy of a deal; 2.4.1 Prelude; 2.4.2 Deal negotiation; 2.4.3 Pre-change of control; 2.4.4 Change of control; 2.4.5 Integration; 2.5 Shareholder theory; 2.6 Excursus of reasons why M&A operations fail

2.1 Introduction

One of the most significant operation occurring in those years is the process of merger and acquisition between firms, usually part of the same industry or acting in the same sector, with the main aim (but not the only one) to improve and strengthen their presence on the market.
In this period of uncertainty and economic crisis, one answer found by companies to grow and realize a structural development that allow them to survive, strive in an even more complex environment, is indeed merging/acquiring resources to maintain the competitive position on the market and perhaps improve capacities during time.[27]
This dimensional growth has many different aims, that can be briefly summarize as follow:[28]

- to reinforce the collection of know-how, resources, knowledge, abilities, competences developed by the company, usually determined throughout experiences accumulated during the years;

[27] Sicca, "La gestione strategica dell`impresa", CEDAM, 2001
[28] Vender J., "Le fusioni e le acquisizioni", in Bertoni A., Bruggeer G., Jovenitti P., Massari M., Pivato G., Scognamiglio C., "trattato di finanza aziendale, Franco Angeli, Milano, 1993

- to obtain a more rapid development than with internal growth, through a minor cost than the entire internal process (t.i., to acquire or merger with a company that is already existent is less expensive, in term of time and cost, than create a new bigger entity from the beginning):
- to reduce the competition on the market;
- to bypass entry barriers and limited resources;
- to take advantage of fiscal benefits.

It is possible to appoint two different dimensions that play a relevant role in the evaluation of the effectiveness of the M&A deal: the financial and the strategical ones. Along the dissertation, i am going to analyze both sides, focusing on the strategical implications that the choice of merger or acquire a firm has on the overall entity, and the accounting process that brings the integration of the two realities into a single one.
Reinforce, extend, explore the competitive environment are just few of the strategical aims that drive the deal. The reinforcement of the competitive arena happens cause the new entity will result in a stronger organism, that on a basic level, would bring economies of scale, efficiency and bargaining power (obviously, those goals are on a theory basis, that means that not necessarily the new corporation will achieve them, but are the inputs of the process). This kind of merger process is identified also as horizontal M&A, to improve the potential or integrate distinctive features of two companies. The extension of the company is achieved by operations between companies that offer products/services that are correlated one the other, that means close from the technological and/or marketing point of view, resulting in a better offer of final product/service, and with the perspective of gaining economies of scope, efficiency into processes and integration (that first of all, brings all the other features). Those last features could be addressed in focusing on the reinforcement of bargaining power and deeper efficiency after the full integration of processes once separated, besides the integration leads to an

exchange of competencies that is assured by the transfer of knowledge between combined entities.[29] The important point here is to keep in mind that the right development of the deal is reached through a common management of processes and resources during the integration after the conclusion of the concentration. When we talk about M&A processes that aim at explore the competitive environment we talk about vertical integrations (the acquisition of upstream or downstream companies removes the risk of diversification typical of segments that could somehow start to act in activities along the same supply chain.)[30] that lead to new activities and competences, driven by the research for new investments in term of financial instruments and risk pooling: risk sharing is due to the already existent knowledge of common processes present between companies that usually are suppliers of clients. Those two matters, risk reduction and financial availability, push firms to explore new competitive fields and can contribute to the creation of value in two different ways: the combination of knowledge already existent and the acquired one, or the passage of managerial competences and leadership capacity in a long term vision. Just to have a tangible idea of this important point, it is enough to think about the acquisition from LVMH of all the smaller companies (such as Loro Piana, just to mention the last one) that are part of the Made in Italy excellences and have an enormous baggage of knowledge, capabilities and culture that are not replaceable anywhere nor could be found anywhere else but in Italy, the cradle of craft and artisan works, the pure example of perfection in handcraft creations and the deeper essence of manufacturing culture. The knowledge acquired by LVMH is impossible to be replicated and this gives an incredible added value to all the manufacturing firms. In this case

[29] Maria Rosaria Napolitano, "La gestione dei processi di acquisizione e fusione di imprese", Section 3.3 La Direzione Della Crescita E I Determinanti Delle Acquisizioni E Fusioni, Franco Angeli editore, 2003

[30] Sicca L.,"La gestione strategica dell`impresa", seconda edizione, Cedam, Padova, 2001

we talk about “complementary economies”because the two realities, in becoming one, complete each other and become source of value higher that previously (the so called complementary economies or learning economies). The strength of the deal arrives at its best if the acquirer is able to keep this knowledge inside and to make it grows even after the acquisition, without suffocating it or forcing (here again, the importance of a correct integration process linked with communication skills of the management). Goals have to be planned not only in the next future but also and especially in a long term view. An interesting research has been done by Walter and Barney concerning concentration strategies and correlation with the trend of growth: authors identified five clusters of motivations composed by many objectives achievable through M&A. Specifically, the research of economies of scale and scope is said to be an important reason to start a deal, together with the mutual management of critical competences between stakeholders (agreements within the supply chain could bring financial returns in term of cost reduction and improvement of turnover, that is translated into more efficiency, faster response to the market and major revenues). Another point is the reinforcement of supply chain and the fields into which the company acts obtained gaining control of relevant market share and pooling the risk of action with the acquired company, plus using the market knowledge acquired to better segment its product and serve more efficiently the environment. Lastly, the M&A deal is driven by the willing of entering new businesses, exploiting and optimizing resources and financial capability (accomplish flow of incomes, for example, through the combination of different economical and financial cycles, or forcing the management of the acquired company to better the performances of the firm in order to increase its value and gain in capital account). At the very end, the authors conclude that the major force that leads the agreement of vertical integration is the management process of critical interdependences; the main reason for concentric M&As is the reinforcement of the competitive position on the market; conglomerate acquisitions are directed mainly at the optimization of financial capabilities and expansion into the competitive environment; while horizontal deals are lead by all the motivations explained above.[31]

Growth trend	Value creation sources
Reinforcement of competitive environment	- Improvement of efficiency - Acquisition of competences and resources - Reinforcement of bargaining power
Extension of competitive environment	- Reinforcement of bargaining power - Acquisition of competences and resources - Improvement of efficiency
Exploration of competitive environment	- Risk reduction/ risk pooling - acquisition of resources and competences - Reinforcement of bargaining power

Table 1 - growth trend and sources of value creation

Once we have briefly seen the determinants of M&A processes, we are now going to see which are the value sources and how value is generated by M&A deals, on a theory level. If an agreement proceeds in the right way and every step is achieved successfully, M&A deal becomes source of added value under those aspects:[32]

- *Economies of scale*;

[31] Walter G.A., Barney G.B., "Research notes and communications management objectives in Mrgers and Acquisitions", strategic management journal, Vol. 11, 1990
[32] Michael, "Practical m&a execution and integration - step by step guide to successfull strategy, risk and integration management", Wiley Corporate Fea 2011

- *Economies of vertical integration* (coordination and administration);
- Complementary resources (usually, small firms gain this);
- Surplus funds;
- Eliminating inefficiencies and strategic realignment;
- Industry consolidation and valuation of undervalued assets;
- Diversification;
- Increasing earnings per share;
- Lower financing costs;
- Solve agency costs;
- Increase market power

Economies of scale, that are referable to cost reduction related to improvements in production volume, and are concerning all the activities of the firm (logistic, production, marketing, finance, etc..), are strongly influenced by the field of action and the target segment in which the company works: in that context in which importance is given to implant dimension and a more radical cost structure, economies of scale could be of relevant importance. Think, for example, about the concentration of entities in sectors that are passing their maturity phase in the product life cycle or those in which demand elasticity is linked with price: those groups gain positive returns from economies of scale. In this context, the so called roll-up strategies create agglomerates in a fragmented market where current competitors do not have enough size to gain economies of scale by their own.[33]

About economies of scope, derive from the common use of resources from different fields (for example, companies using the same raw material for different scope, or the acquisition of knowledge after a process of concentration).

[33] Goedhart M., Koller T., Wessels D., "The five types of successful acquisitions", Mckinsey on Financa, n. 36, Summer 2010

The dimensional growth achievable through M&A has different purposes, as we saw above, and different benefits. Few of the most important features acquired thanks to the completion of the deal are common use of resources, transfer of competences between firms and new capabilities (not to mention the " automatic benefits”, t.i., advantages against stakeholders, market share, that are not relevant under the strategic point of view concerning the major intrinsic value of the new entity).

Thinking about sharing production, R&D, distribution, logistic costs, or the common use of distribution channels, know-how, technology and marketing competences, we can appreciate the positive aspects linked with economies of scale and scope, besides the transfer of capabilities and knowledge is another key benefit to link with economies of scale and improve the effect of the agreement. Sharing competences is a way to improve tasks and tools owned by each single firm, that together can achieve higher results unifying productive competences, technologies, R&D processes and knowledge acquired, marketing and distribution.[34] Thus, M&A strategy puts the companies in the condition of acquiring reciprocal resources that they don`t own singularly, and it does not only represent the source of new competences and reinforcement of knowledge and financial basis, but also is an instrument to learn partner`s capacities and opportunity for creation of new potential competences.

A survey by McKinsey states,[35] there is no magic formula to make acquisitions successful. Like any other business process, they are not inherently good or bad, just as marketing and R&D aren’t. Each deal must have its own strategic logic. The authors identify five archetypes that lay behind the achievement of benefits from an acquisition deal, encountered in the reality among their clients: improving the performance of the target company, removing excess

[34] Haspeslagh P.C., Jemison B.D., “Managing acquisitions. Creating value through corporate renewal”, The free press, New York, 1991

[35] Goedhart M., Koller T., Wessels D., “The five types of successful acquisitions”, Mckinsey on Financa, n. 36, Summer 2010

capacity from an industry, creating market access for products, acquiring skills or technologies more quickly or at lower cost that they could be built in-house, and picking winners early and helping them developing their businesses.

Those boundaries are the effective combination of the positive effect achievable by the firm that we presented above, and as well, if a company acts out those aims will be unlikely to create value. Roll-ups, consolidating to improve competitive behavior, transformational mergers, and buying cheap, are few reasons gave by executives to justify the acquisition, even if they seldom achieve the final goal if the process is not coupled with a clever logic behind.

To improve the target company's performance is one of the most common value creation strategy, adopted frequently by private equity firms that acquire a company with the aim of improve its potential and strengthen its core competences and financial basis, and then sell it on the market at a major price to gain consistent profit from the transaction (reduce costs, improve margins and cash-flow). The acquisition of a target company allow an increase in operating profit margins of about 2,5% more than those at peer companies during the same period, thus many of the transactions increased the operating profit margin even more.

A common event is the development of excessive capacity within the industry, as this becomes more mature. To absorb this extra capacity, companies tend to acquire other companies in order to consolidate their presence on the market. This action usually allows the accumulation of bulk of value to seller's shareholders, not the buyer's.

Nowadays, many small firms have in their composition a strong potential, limited only by the little dimension of their business and the incapacity (linked to absence of financial resources) of entering bigger markets: let's think about pharmaceutical companies that rely on small research centers or chemical firms, or the ones that have an important know-how but not the strength to compete with giants. Those companies (like the excellences present in the italian clusters of nanotechnologies of handcraft manufacturing) have difficulties reaching the entire potential market for their products. Sometimes it happens that bigger companies, pharmaceutical corporations or big fashion groups, acquire the smaller ones and use their large-scale sales forces to accelerate the sales of the little companies' products, gaining advantages no terms of knowledge and competences. This way, both companies receive benefits from the “partnership”, one gain market share against other small competitors, the other gain competences and specific know-how that can help in offering a better product on the market accelerating revenue processes.

Linked with this aspect, the specific willing of get skills and technologies faster or at lower costs than build in-house: the big company acquire the smaller one to close gaps in its technologies, as the example of Cisco Systems proves. From 1993 to 2001 Cisco acquired 71 companies at an average price of approximately $350 million, increasing its sales from $650 million in 1993 to $22 billion in 2001 with the majority of 2001’s revenues consequent to acquisitions (Cisco Systems grew up rapidly through acquisitions that closed the gaps in technologies allowing the enterprise to become a supplier of internet equipment as a whole, not only a single line product as it was at the beginning).

Another winning strategy is to acquire a company in its early steps of the life cycle, before any other potential competitor perceive the potential of growth. This is a pretty threaten strategy because if the management does not apply the right forecasts of the future activity, it will fail in a useless deal. Thus, considering the advices and considerations by analysts of McKinsey, this strategy requires an ordered approach in three dimensions that concerns more cultural importation of the management rather than true structured administrative processes: the firm has to invest early on the target, before competitors and market see the company’s potential, and doing so it has to proceed with multiple bets being prepare that some of them will probably fail.

Lastly, skills and patience are needed to feed the acquired firm in order to make it grow.
As we saw, there is much behind scene than financial options. M&A is not only about merging two companies to create a more powerful entity, the firms that stop at this point waste the majority of benefits deriving from this process. M&A is the intimate union of two bodies that integrate perfectly their activities, culture, management, perspectives, to create something that goes beyond the mere balance sheet, the blood of the evolving economic environment.
It is like a marriage: the one made with convenience purpose is destined to remain, probably, an empty box, just a cold union that leads to benefits in the short term. Whereas a marriage driven by love and patience is expected (and usually will do) to give more stable, true, and valuable effects, leveraging on long term relationship and creating a powerful force. This long lasting beneficial marriage is based on a business strategy that uses capabilities as the basis for inorganic growth.
Thus, in general, we can say that leverage on specific strengths of the company outperform the results of other actors in the industry: a study by Adolph, Mainardi and Neely investigates how deals that are made to enhance the specific things that companies do well consistently do better than others (companies that apply this kind of strategy basing their choice on fit, obtain a Compound Annual Growth Rate 12 points higher in shareholders return than M&A deals obtained by other buyers). Capability-based strategy rewards with more value.[36] The study reveals that similarities between companies that are dealing (even in the case of the so called "Pac-Man companies", the ones that acquire systematically other firms) are far more likely to generate value over time after the completion of the agreement.
The capability system is composed by features that support and drive the company's strategy, integrating people, processes, and technologies to

[36] Adolph G., Mainardi C., Neely J., "The Capabilities Premium in M&A", strategy+busines by PWC, issue 66, spring 2012

produce something of value for customers (not only capabilities such as tax, legal, operations, or competitive necessities). These are complementary and differentiated, in order to achieve company’s long term strategy and market position. Of course, this system is not easy and is multifunctional, tiding close to the identity of the company: to have a clear idea of who the company is, what it does and where it wants to go, gives a real competitive advantage. Companies that apply this kind of strategy avoid trying to win in areas that are not the core ones, even if this sometimes means a lost in rapid profit or diversification of business, it reduce the chance of loose investments and limit the magnitude of mistakes. The capabilities orientation is particularly valuable in M&A deals, where time is short and stakes high, and executives can push on company’s capabilities to end up with a rapid and reliable guide to sound judgement. Through their experience, the authors collected data and noticed a pattern: those companies using their capabilities as starting point in the process of targeting and acquiring another entity, ended with a value major than expectations: In the due diligence the executives asked themselves “What do we do uniquely well?How does this perspective deal fit?”, rather than focus the attention at financial attractive opportunities, and they made their choice accordingly. Everybody talks about fit when it comes to M&A, but the example of those successful companies seemed to have an unusually clear idea of what fit meant: it’s not a matter of adjacency (t.i., services, products, industries that are close to the company’s one), but coherence between capabilities and the system into which the company moves, aligned to its market position.The observations that the authors made brought them to see the process as reverse, starting from the question “would we find a correlation between capabilities fit and deal success?”, they isolated potential M&A success factors dividing the deals by their stated intent, thus capturing the prevailing purpose of each. This through the use of five intents: capability access deals (where the goal is explicit and to appropriate target company’s capabilities), product and category adjacency deals (t.i., a company acquires one that offer a similar product or service, but not the same one), geographic adjacency deals (t.i., merger or acquire to expand into a new location instead of an industry), consolidation deals (in which the intention is to take advantage of economies of scale and synergies) and diversification deals. Then, they categorized them by their capability systems: enhancement deals, leverage deals, and limited-fit deals. The authors analyzed the impact on acquirers' shareholders value after two years from the deal, and valuated the performance of the operation. The finding was in line with the initial belief: the companies that leverage on capabilities had better shareholders return, than the ones that did not. The highest return was found in the leverage deals, in which the acquirer makes use of capabilities gained by the target firm, improving systems for both, in this way creating an ideal environment in which thriving together. Usually, those are low risk deals, cause the acquirer does not need to change its capabilities system: an example of this integration is the acquisition made by Oracle of Siebel Systems, Hyperion Solutions, and BEA Systems, which gained capabilities of database management and sale and integration of enterprise software by Oracle.

Enhancement deals, that consist in the addition of new capacities to fill a gap in the existing one, are the second most premium deal: leading to changes in the core capabilities, at least in the short term the return is lower than the one in leverage deals, because integration time is needed and results could be visible only in the medium-long term. Besides, those kind of deals can require investments, involve market risks, and take more time to give their fruits. One example is Disney company: after the acquisition of Pixar, the company enlarge its capabilities in the segment of entertainment to children and teenagers, revitalizing also its core business a producer of animated films.

The limited-fit deals are the ones with less return, and sometimes are the ones producing negative results: flawed deals that ignore capabilities are difficult to produce positive income because the acquirer does not posse the system of knowledge necessary to leverage the acquisition, and neither a good post-merger strategy could save it (to be underlined that the negative result is obtained if compared with the one of a similar company that took into consideration capabilities). This deal is different from diversification, because, even if the link is blurred, there is a kind of fit between activities merged, while in the diversification deal the field of action are completely different (e.g., William Morrison Supermarkets' acquisition of Safeway, a UK convenience store chain, or the merger between Biogen and IDEC, one acting in the segment of biotech and the other in the pharmaceutical one).

If we consider profitable M&A processes (in whatever field, from construction to food), we can agree with the authors in saying that deals led by capability systems obtain better return for shareholders and both company's activity, especially in mature industries. The progressive merging process between firms within the same segment heads consolidation in the industry not around assets but around distinctive capabilities systems. The results of the study conduce to a reflection: the old logic is concentrated on financial questions rather than strategic issues. Nowadays, capabilities are the new gold for firms, able to create future value when synergies are conduced carefully and using wisdom. Nevertheless, financial aspects have to be considered and analyzed, of course, but a deeper attention must be paid also on qualitative aspects of the deal. For many companies, strategic capabilities are not the perspective to be considered, but just a functional matter to be solve after the merger conclusion, in the integration process. Instead, they are crucial levers of value creation. Questions that move from the mere financial aspects, like "how much of a premium in justified? Does it make sense to use debt? What short-term synergies can it drive?" stem from a narrow vision of the firm that does not consider the strategic implications of capabilities on the positive result of the acquisition and future vision. To go beyond financial and legal considerations to focus on technological, organizational, and cultural issues is a qualitative assessment that involves much many actors, reasoning on long-term value of deals.

After the transaction is completed, the management has to avoid behaviors like “I bought you, so everything happens my way” and has to be ready to change the road from the designed one: a positive example is the merger of Pulte Homes Inc. and Centex Corporation in 2009.

The original plan of Pulte was to eliminate redundancies within the construction industry,that was passing a struggling period after the crisis.

After the acquisition however, the executives of Pulte understood that through the acquisition they bought also some significant capabilities of Centex, a sophisticated and highly efficient methodology for managing the homebuilding process from design to supply chain to construction, and instead of cutting across the board, Pulte spread those capabilities and incorporated them into its system. Although the housing downturn continues to challenge Pulte, the integration of Centex’s capabilities is worth thousands of dollars per home, a much needed advantage in this challenging industry.

This philosophy of action is not immediate, it requires years of action within the field of M&A to be refined, and is easily achievable by the so called Pac-man companies, the ones that systematically acquire in order to expand their business. Also in this context, the authors found example of capability systems oriented enterprises, underlining the importance of qualitative aspects in the valuation and integration process.

It is possible to observe that the final goal is to obtain short term results, the firms can adopt different approaches: they can buy, restructure the acquired company and then sell it at a higher price, or just slashing expenses and sell it; techniques used by private equity funds, that want to “speculate” on the value of a weak company to obtain a premium reselling it after have solve its problems. Those approaches have less value than strategic deals that want to achieve a stable and long term return. M&A with orientation to capabilities integration is far more enduring, because it puts assets, products, services into the hands of companies that can make the most of them.

Nowadays, companies and physical resources are no more the primary important features of M&A deals: an increasing importance has been given by intangible capital (t.i., all the range of capabilities, leadership attitude, customers' loyalty, experience owned by the company and the target one that makes them appreciable on the market).[37]

Those are all not concrete aspects but anyway they represent a certain part of value within the firm: that intangible capital is in a constant state of flux, oscillating back and forth from an 'active' to 'inert' state. Moreover, intangible capital is able to serve its value-creating purpose only when it is in an active mode, this is the consideration made by analysts of Hay Group, an international consulting firm that studied the impact of intangible features on M&A deals. Here a brief representation of the aspects identified as relevant:

Hay Group's intangible capital model		
Organizational capital	Relational capital	Human capital
Cultural and market convergence	Brand	Leadership
Governance	Client intimacy	Employees
Agility	Client loyalty	Development and management
Communication and teaming	Examining networks	Engagement
Energy and clarity	Internal networks	
Organizational structure		
Tacit 'know-how' and innovation		

The intangible drivers could affect the effectiveness (or not) of the deal because are those features capable of changing the characteristics of the

[37] Derain D., Publication "Managing intangible capital in M&A", Hay Group

tangible firm. Assets are easily valuable, rather than intangible options that influence the operational return as well but are less clearly identifiable.
in the M&A survey by Hay Group, 71% of sales volatility was due to intangible capital reverting to its inert state.
Thus, intangible criticality linked to intangible assets become increasingly important over the acquisition schedule, also because, as mention above, it is the state (and not the valuation) of intangible capital that drives a successful M&A; that is why it is important to pay attention during the earlier stages of the process, as opposite to solve issues after, achieving greater accuracy when dealing.
Moreover, to identify at the beginning the key intangible drivers help firms to create and modify the best roadmap for its merger analysis and pinpoint early the high potential target (in the screening phase).The research of those aspect could seem to be easy, but it is not: intangible capital like leadership skills, employees, brand management, governance, are not easily visible, neither easy to be kept.
Making a step back, we have to analyze the process of technical sequences that compose the overall system of M&A.

2.2 Merger, acquisition, demerger: a basic definition

Thus, behind the final action of merging/acquiring or set a partnership, there is a fairly complex process of valuation that allows the acquiring firm to decide whether and which could be the best target company to merger with/acquire/partner. This process is composed by different stages that will be presented in this dissertation, while the main aim that i want to achieve is the presentation of strategical implications and consequences of processes of M&A and partnership (inside the SCM of a company): every time two entities merger/partner is because the value of the new entity would be higher than the single ones, and this of course affect the internal processes, allowing to speed up the SC and make it become "easier" to be managed (t.i., is easier to manage one single company, than two different ones).

In the range of different kinds of strategies, can be identified mergers, acquisitions (or Takeovers) and demergers.

2.2.1 Mergers

Joining of two separate owned corporate entities. The basic belief underneath this choice is that two firms combined can achieve better results than single ones. The ownership of the new entity is shared between shareholders and investors of the two original companies. It takes place when the two firms combine to become one; assets and liabilities are brought together and shared, as ownership.

2.2.2 Acquisitions

One firm acquires the other, taking over the ownership and combining it with their organization. Typically, the acquired firm is brought at a premium price, over its market value (payment may be in the form of cash, stock (shares) or other assets. The acquiring shareholder becomes the owner of the new entity/combined company.

Though when stock is used to pay for the acquisition the transaction can, in theory, take on some of the characteristics of a merger as both sets of shareholders share the ownership. Assets and liabilities, if not otherwise agreed, are assumed by the acquiring firm.

2.2.3 Demerger

It occurs when part of an organization is sold to an acquiring oneor a business unit is being "spun off" (that means it's allowed to become a legally independent/separate company). Sometimes, the initial ownership is still in the hands of the "parent company", is the same one, or there might be an initial public offer (IPO) to place the stock in the stock exchange, a management buy-out (MBO) where the management of the business unit buy the business unit or the unit is simply sold to another. In this situation is crucial to have a clear situation about assets and liabilities that are being separated to form the new entity.

2.2.4 Mergers VS acquisitions

Is worth remembering that many mergers are, in fact, acquisitions: presenting an acquisition as a merger has both tax impacts,(--> to be discussed) and softer personnel impact. It allays fears and any "hard feeling" among the company and consumers being acquired. To be truly identified as a merger, two companies of a roughly equal size "simply" become one, without passing money from one to the other, while in an acquisition, a company pays for an ownership stake in the another company. Mergers can be seen in terms of consolidation and transfer of ownership. The "shape" of a deal can also be understood in terms of the type of integration being achieved.

Going in order, the first part of the dissertation will present the way M&A and alliances are structured, and how supply chain works, from the theory point of view, then the second part will pay more attention on the strategical implications of those actions, allowing us to understand what there's behind the scene when the companies decide to proceed with the creation of a single entity or a strong partnership. At the end, i'll present few examples that will allow to better understand the reasons why and the implications of those kind of processes.

2.3 M&A process definition

From the theory point of view, the process of merging/acquiring two firms is divided in phases, that begin with the identification of a target company by the acquiring one, chosen from a pool of potential companies, based on different aspects (i.e., cash flow, stability/solidity, field of activity, consistency, business..), to end up with the proposal of acquisition that present the value that the company is willing to pay (and the different ways that it identified to conclude the payment).

Depending on the company that is going to be acquired/merged/partnered, is possible to identify three types of deals: vertical merger, horizontal merger, conglomerate merger:

- horizontal mergers (occurs when two similar companies combine; create a new stronger organization)
- vertical mergers (two companies in the same industry but in different parts of the supply chain; better channel, positioning, savings in costs, pricing opportunities)
- conglomerate mergers (two organizations in unrelated markets merge; speculative, opportunistic, diversification)

2.3.1 HORIZONTAL MERGER

Is a process occurring between companies within the same industry, and represents the business consolidation of different firms who operate in the same space, that usually are competitors offering the same service or product. This kind of expedient is more usual in that industries where competition tend to be high and synergies and potential gains from concentration are much greater for merged entities than single one. Companies looking for efficiency and economies of scale frequently merger: it is enough to think about mergers happening in the automotive or airline sectors, where the strong competitive environment incentives the partnering of companies to leverage their market position and increase market share of the merged entity. Thus, the merger process could cause a flattering in competition, that could affect the market in the moment that the new firm obtains a sort of monopoly (thus, horizontal mergers are monitored by the Antitrust agencies in order to avoid the presence of too powerful companies that could create unbalances within the market through merging deals): because market efficiency depends on the market control of each firm, which depends on the number of competitors, concerns arises if that number declines. Fewer competitors mean each firm has more market control and the overall industry tends to be less efficient.

The main aim that companies dealing into an horizontal merger want to achieve is to increase their revenue by offering to customers an additional product (for example, using the geographical presence of the counterpart to expand the area of influence, or exploit the market penetration of competitors). Besides, as mentioned above, the aggregation of companies within the same industry generate a decreasing in competition that could be valuable for both companies and customers.

The bank industry is a clear example of how companies merger in the same sector to gain in terms of: economies of scale, market share, new customers, new market opportunities, cost reduction, leveraging current assets and services. In many countries, global or multinational banks are extending their operations through mergers and acquisitions with the regional banks in those countries. These mergers and acquisitions are named as “cross-border mergers and acquisitions” in the bank industry or “international mergers and acquisitions” in the bank industry. By doing this, global banking corporations are able to place themselves into a dominant position in the banking sector, achieve economies of scale, as well as garner market share. Just to mention few of them: the merger of Chase Manhattan Corporation and Bank One with J.P. Morgan & Company; the merger of Golden State Bancorp Inc. with Citigroup Inc.; the Australian Commonwealth Bank acquired Bankwest and Aussie bank, aiming at reducing competition and target different segments of customers; Unicredit Group merged with the German group HVB and ATF Bank. Those examples are just a few of the multitude that characterize the banking sector, in which acquisitions and mergers are common instrument to enlarge the presence of the main group abroad and offer a more integrated service, besides shrink competition.

2.3.2 Vertical Mergers

The vertical merger occurs between companies acting in the same supply chain, between suppliers and manufacturers, that decide to merger into a single entity to facilitate the exchange of products between divisions. That is to say, vertical merger has the aim of increasing efficiency and consequently increase profits for the acquiring company reducing the distance between different levels within the supply chain, enhancing the operating processes.

Companies decide to vertically merger for a variety of reasons attributable to reduce uncertainty over availability, quality of suppliers or the demand of input, when the relationship between subjects is strict and the goods are critical for each company (t.i., is more convenient for both to secure their relationship through a more stable and profitable deal), then to take advantage of available economies of integration, to protect against monopolistic practices of suppliers or buyers, and to reduce transaction costs (e.g., sales taxes, marketing expenses).

Differently from horizontal mergers, in which the final number of companies decrease after the completion of the deal, vertical integration does not change the concentration of the market. Instead, it could modify the equilibrium within it, changing the patterns within the industry: suppliers may lose market for their goods, retail outlets may be deprived of suppliers, competitors may find that both suppliers and retailers are blocked, this because relationships with other companies become stronger and somehow monopolize resources. From the customer perspective, a vertical integration of upstream firms can lead to positive effects such as decreasing in prices linked with less intermediate passages and consequent less mark-ups, cost reduction linked with the decreasing in transfer costs that then bring decreasing in prices (technically, even if could happen that the customer does not feel the positive effect of concentration as much as the companies do).

The next table gives an overview of aspects to be considered by the company when deciding whether integrate or not. It has to be leveraged the trade-off between costs of integration and benefits deriving from it.

Setup costs	**Transaction costs**	**Transaction risks**	**Coordination effectiveness**
Capital (e.g., equipment, acquisitions)	Information collection and processing	Possibility of unreasonable price changes	Run lengths, inventory levels
Systems development	Legal	Supply or outlet foreclosure	Capacity utilization
Training	Sales and purchasing	Insulation from market (e.g., from technical changes, new products)	Delivery performance
			Quality

Table from McKinsey “When and when not to vertically integrate” by John Stuckey and David White, lists costs, risks, and coordination issues that should be considered in the integration decision

From the company's perspective, a study by McKinsey analysts identified few reasons that can justify the vertical integration of companies:[38]

- The market is too risky and unreliable to play single roles;
- Companies in adjacent stages of the industry chain have more market power than companies in your stage;
- Integration would create or exploit market power by rising barriers to entry or allowing price discrimination across customers segments;
- The market is young and the company must forward integrate to develop a market, or the market is declining and independents are pulling out of adjacent stages;
- Acting together is more profitable than acting singularly in an open market.

The instrument of vertical integration within the supply chain is usually easier to be found in sectors, such as automotive, construction or manufacturing, where certain intermediate products are highly critical for the main company, that thus decides to proceed merging: an automobile company joining with a parts supplier starts a deal that would allow the automobile division to obtain better pricing on parts and have better control over the manufacturing process. The parts division, in turn, would be guaranteed a steady stream of business. Concrete example in the American market is the vertical merger that took place in 2000 when internet provider America Online combined with Time Warner, the media conglomerate: the merger allows Time Warner to supply content to customers through properties like CNN and Time Magazine, while AOL distributed such information via its internet service. Another interesting example is the acquisition of PayPal by E-bay, in order to provide a more

38 [http://www.mckinsey.com/insights/strategy/when_and_when_not_to_vertically_integrate]

integrated service to customers and facilitate payments through the web, or the oil and gas companies that acquire/merger with downstream firms to accelerate the process of oil-refining and distribution, in a very delicate sector such the oil and gas one.

2.3.3 Conglomerates

A conglomerate merger is a deal that involves companies operating in diverse sectors, that want to enlarge their field of action or simply enter into new markets through a completely new activity, without taking the risk of starting a new business but acquiring an already existing one. The companies have no common interest, are not in competition with any of the same competitors, and do not make use of the same suppliers or vendors. It is possible to distinguish two types of conglomerate: pure and mixed. The pure form involves firms with nothing in common, while mixed form involves firms that are looking for product extension or market extension.

In theory, the firms in a conglomerate merger have no overlapping factors, but in practice there may be something that they see as important that have drawn them together. They may see overlap in technologies, production, marketing, financial management, research and development or some other factor that make them think they would be a good fit for each other. Another reason one firm may want to acquire another firm is to diversify its operations. If a company has just one line of business, it is very vulnerable to the ups and downs of the larger financial markets and the economy. If it introduces one or more new businesses in different areas of business under its "umbrella," it diversifies its product line and becomes less vulnerable to the whims of the market. Conglomerates are not that easy to be identified, because sometimes they could seem to be vertical mergers. An example can be Sony. Born as a customer’s electronics manufacturer, it moved into the entertainment and media industry through the acquisition of Columbia Pictures Entertainment

Inc., in order to enter a new market. This can be viewed as mixed conglomerate, because even if the two sectors of action are different and the final customers can not be assimilated, something in the products and services provided can have common features(t.i., Sony produces appliances that can be used in the entertainment sector, and then uses those in Columbia Pictures productions).

Even if there are different kinds of merger, as we saw above, the sequence of stages that brings to the final deal is the following (depending on the kind of agreement, one step could be evaluated more than the other or developed in different way, but the basic sequence of actions remain):

- Business valuation, is the definition of the value of present and future target firm's performance conduced through research, investigation, about capital gains, organizational structure, market share, distribution channel, corporate culture, specific business strength, credibility;
- Proposal phase, in which the company send to the target a proposal for merger/acquire detailed with strategies, amount, commitments, usually is a non-binding document;
- Planning exit, has to be managed when the target company decide to undertake the operation (i.e., when and how to make the exit in an organized and profitable manner), at this point, financial and business issues have to be considered di the management (full sale or partial sale);
- Structuring business deal, that consist in the definition of how the new entity has to take initiatives for marketing and create innovative strategies to enhance business;
- Integration, where the companies coming together with their own parameters (prepare documents, signing the agreement, negotiating the deal, defining the parameters of the future relationship);
- Operating the venture, fulfill the requirements and desires of the companies involved;

- Business as usual, occurring once the process is concluded and the new entity start to operate effectively.

The final goal of a merger/acquisition to happen is the increasing in value for shareholders. Other alternative ways to increase the value of the company are: business alliances, joint ventures, strategic alliances, minority investments, license franchises.
There are alternatives from the various business alliances to going it on your own through a solo venture. Which method is chosen depends on management's desire for control, willingness to accept risk and the range of opportunities present at a particular moment in time.[39]

2.4 Anatomy Of A Deal

2.4.1 Prelude

The most strategically critical part: is the phase where the decision if to merger or acquire is taken. the risk is low and there is the chance to change idea about the effectiveness if the deal.If errors are not rectified at this stage, they will be costly to correct later. Reasoning and key objectives are the crucial points that have to be fixed and identified in this step: WHAT DOES THE COMPANY WANT TO ACHIEVE AND HOW? In this phase there is also the identification of the target of the merger/acquisition: defining the type of organization to target, identifying firms that meet this criteria and selecting the organization you want to acquire or merge with.
Intent: clearly defined strategic intent to acquire or merger. To decide and validate the strategic decision to engage. Once it is done, perspective targets

[39] Depamphilis D., "Mergers and acquisitions basis, all you need to know", Academic Press Of Elsevier, 2011

are identified and evaluated (engagement and negotiations strategy will decide how the target will be approached).

interaction of planning and actions: number of different parallel activities that will happen during the integration period: clarify the objective of the deal; define the characteristics of the potential target; scan possible targets and compare with the objective one; select the possible target or short list; examine the likely value of shortlisted targets and consider the likely structure and cost of the deal; clarify and quantify the merger value of those target companies; evaluate what an integrated firm would look like; staff changes; manufacturing locations; competitor response; logistics; value on your complete supply chain. Good m&a start with due diligence. good m&a end with integration (due diligence inform the tactics underlying the strategy of M&A for a given company; DD is probably the single most important element in M&A process, and can play an important role in negotiation process too: it allows you to see the true value of the firm and objectively demonstrate it to the potential target, besides it can strengthen the acquirer's position.

2.4.2 Deal Negotiation

The aim is to reach a definitive and complete agreement. The key point of this phase is the definition of the deal in all its aspects because once it has been signed, it binds companies, so is necessary to set it in a clear way to allow parties to be aware of what the agreement contain and what will happen later. The process of negotiation needs to address the legal, structural and financial aspects of the deal, and at the same time key talent can be identify and secured accordingly. On the back of earlier research and ongoing due diligence, the process of negotiation will allow you to reach a price or valuation for a deal which is ongoing to be in the range that will allow both parties to benefit from the transaction. Another crucial aspect dealt in this phase is the definition of any related agreements, such as that of transition services (Transition Service Agreement): use of a data centre, access to key internal applications such as payroll, telephony, power, light and premises. the best way to decide if a TSA is required is simply to consider what will be needed for the first day and the period following that from the "other side", without which the organisation's operation would be impaired (key tasks to consider are: identifying where TSAs are required, involving subject-matter experts in the process from the start, peer reviewing the agreement).

2.4.3 Pre-Change Of Control

Many activities: completing due diligence to make sure the company is worth what it is thought to be worth. It is necessary to keep the two organizations functioning effectively. Prepare for the change of control (seeking regulatory and shareholder approval, for example). Prepare the ground form post-merger integration activity. Decisions made on post-merger approach and strategies will impact how the change of control weekend (cutover weekend) is progressed. Considerable headway can be made here on progressing the integration. It is also the stage when all predatory work for the integration of the two firms should be completed.This section of the M&A process is about taking the two organizations from having agreed a deal to being ready to execute the CoC (Change of Control).

Several forms of approval are required: who constitute the stakeholders community will vary from deal to deal, and each of the bodies that grant approval should be treated as stakeholder and carefully managed as the deal progresses: regulators, shareholders, employees, trade unions, management, competitors. The process of planning might be something like this:

1- identify which of the aforementioned shareholders will need to be engaged,

2- identify the approvals each needs to give,

3- if there are specific requirements, these need to be identified along with what documentation each regulator will expect,

4- identify which are the specific concerns that stakeholders are likely to have regarding the deal,
5- formulate a clear strategy to engage with each of these stakeholders, as to how their approval will be sought and secured (and contingency plans on how to deal with regulator reaction),
6- strategic consideration needs to be given to what might be "offered up" in order to gain approval,
7- understand the duration and any lag times in each step in the process and any possible variation in them,
8- identify and reflect the hard dependencies within the various approval streams,
9- identify any potential soft dependencies that may exist and that should be respected.

2.4.4 Change Of Control

Is firstly about legally transferring the ownership to the new entity, plus making sure the organization can operate as a single entity. It is the moment at which the actual integration between the two firms can commence, and the value of the deal can begin to be realised.

2.4.5 Integration

Is the longer term program of change that realises the benefits of the merger or acquisition, much of the intended value of the merger is achieved through the restructuring of the synergy objectives which are realised either at the moment of integration or during the integration phase.

A good integration process will deliver benefits immediately, at the CoC, and have an intermediate target to deliver most areas of value within a few months, say 100 days. The two "magic" ingredients of integration are clear understanding of the objectives of integration and the capability to deliver it.

Since here, i've talked about shareholders interests and how those affect the decisions of the board on how to proceed the deal. Shareholders interests are very important to be considered because are the ones that allow the company to operate (they give their contribution to the activity through stocks and active participation), thus their interests have to be carefully considered by the board and the entire process of M&A in order to avoid that key shareholders could leave the company.
The crucial position that those actors recover make it necessary to explain the shareholder theory.

2.5 Shareholder Theory

The sole responsibility of business is to increase profits. In order to do so, shareholders delegate management to act in their belief, professionally, to maximize the return of their investments. Managers in this context are agents morally and legally obliged to serve the shareholders' interests, in conformity to the basic rules of the society, both those embodied in law and those embodied in ethical custom.[40]
The influence of shareholders could be negative for the company when the run toward increasing profits becomes unbearable: the management has the pressure of the result, and this is a detriment for the overall business, because does not create a livable, stimulant and positive environment in which to grow.
The "evolution" of the shareholders theory by Friedman, that focuses its attention on the interests on a narrow group of subjects, is the stakeholders theory, that in-globe all the actors that directly or indirectly are affected by the firm's action (t.i., employees, customers, suppliers, creditors, the community, competitors,..).

[40] Friedman M., "The social responsibility of business is to increase its profit", New York Times, September 13, 1970

The broader concept was presented by Edward Freeman, that recognized it as an important element of Customer Social Responsibility. Nowadays, this concept of genuine attention to economic, legal, ethical, philanthropic affairs, is claimed by the majority of companies in the market as part of their corporate strategy. Enlighten shareholder value states that "corporations should pursue shareholder wealth with a long run orientation that seeks sustainable growth and profits based on responsible attention to the full range of relevant stakeholder interests". Essentially, it focuses on generating shareholder value, whilst having regard to the long term external impact of the wealth generation.

The fundamental distinction is that the stakeholder theory demands that interests of all stakeholders be considered even if they reduce company profitability.[41]

The two theories struggle somehow, when it comes to the crossroads where shareholders interests head different ways. For example, a firm is considering to close a plant to delocalize: on one side, if the company moves away it would fire the employees, in order to continue its activity (and generate profits): this is the shareholders perspective. On the other side, the firing of employees would decrease the wealth of society, so it is not a chance to be considered as favorable from the stakeholders' perspective. Thus, it is possible to say that it is a choice based on personal considerations of management, that considers its own health (t.i., of the company) more important than the wealth of the local community: the bankruptcy of the company would cause worst effects on the system as a whole, so it is better to sacrifice the wealth of a restricted group rather than the majority (to be noted that, to give the appearance of well acting usually companies delocalizing their business offer to employees the opportunity to move as well, thus shifting on them the responsibility of the choice).

[41] Smith H. J., "The shareholders VS stakeholders debate", MIT Sloan management Review, July 15, 2003

It would be interesting to investigate deeper the differences between the two theories and the implications that those have on the everyday actions, but this is not the place for it.

After a brief introduction about definitions of shareholders theory, it is time to see which are the implications of merger and acquisition deals on those relationships: clearly, the dealing process changes the patterns of business and new equilibrium has to be defined in order to obtain the desired result from the agreement.

The importance of shareholders, whether we consider the broad definition or the narrow one, is essential to the corporation. They are the subjects that provide company with the resources necessary to generate profit, are the ones that take the risks of action and that valuate the operative returns of their investment. Additionally, company policies, processes and procedures with respect to stakeholders clearly have an impact on stakeholders and the natural environment, forming the basis of a relationship that can potentially contribute to the company's success or detract from it: that is, a resource for the company. Some empirical studies[42] have found that corporate reputation as well as financial performance can be enhanced when stakeholder relationships or the practices that support them are better. The implication is that better stakeholder practices can potentially create better stakeholder relationships that serve as a strategic resource, meeting the Resource-Based View[43] of the firm's criteria of rareness, valuable, non-substitutability and non-imitability. This tight relationship that tie company and stakeholders has to be managed carefully, it can become a source of competitive advantage. This relation could be affected by the process of M&A, that inevitably will change the patterns

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[42] Waddock and Graves 1997
Berman et al. 1999

[43] Barney, J.B., "Firm Resources and Sustained Competitive Advantage". Journal of Management; 17, 1, pp.99–120, 1991

Barney, J.B.; Wright, M.; Ketchen Jr., D.J., "The resource-based view of the firm: Ten years after 1991.", Journal of Management; 27 (6), pp. 625–641, 2001 between subjects. The challenging action is to be able to keep the strategic connections even after the deal, managing them and maintaining the key figures updated along the entire process to make them aware of what is going on.

Acquiring-firm shareholders may suffer from overpayment, while target-firm shareholders may benefit in the short term, although some claim that the question remains unsettled.[44]

The attention on key stakeholders must be reminded along all the process of dealing, starting form thee pre-merger practices.[45]

Considering an hostile takeover (in which the acquiring company simply buy the target one without dealing with it, or not in the proper sense, considering that the acquisition will proceed even if the target company is not dealing). In this situation is obvious that the major stakeholders, even i probably they will gain from the agreement, could not be positively settled against the acquiring company: some ethicists hypothesize that M&A, particularly hostile takeovers, may be harmful to (non-investor) stakeholders because M&A externalizes some costs to certain stakeholders thereby reducing the level of innovative

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[44] Jensen and Ruback 1983; Lajoux and Weston 1998; Rau and Vermaelen 1998

In an exhaustive study, Agrawal a al. (1992), testing Jensen and Ruback's (1983) findings, determined that the efficient market hypothesis, which suggests that M&A should be profitable for shareholders, remains unresolved, finding that acquiring-firm shareholders actually lost approximately 10% of their market value in the five years post-merger, rather than gaining (see also Davidson et al. 1989; Kohers and Kohers 2001).

Another study, using a control group of non-acquired companies, finds that post-merger performances of both the non-acquired and target/merged firms is similar (Langetieg 1978), a result consistent with related research (Lev and Mandelker 1972; Malatesta 1983; Franks a al. 1991).

Acquiring-firm shareholders and other stakeholders may benefit less or experience neutral returns (Jensen and Ruback 1983), because they incur the costs of acquisition, problems of integrating the target firm, and servicing debt (see also Davidson 1989; Hitt et al. 1991; Ahuja and Katila 2001).

[45] DePamphilis D., "Mergers, acquisitions, and other restructuring activities", section "the implications of mergers and acquisitions for shareholders, bondholders and society", p. 28 and following, Elsevier, 2014

stakeholder practices (e.g. laid-off employees, reduced donations to local communities or even lost customers resulting from service impairment).[46] In contrast, proponents of M&A claim that mergers benefit society and stakeholders because they create more efficient markets and improve managerial performance.[47] The understimation of sgareholders interests could lead to the failure of the operation of merging, because of many reasons that are going to be presented below.

[46] Chase et al. 1997
[47] Waddock S., Graves S.B., "The impact of merger and acquisition on corporate stakeholder practices", The journal of Corporate Citizenship, June 22, 2006

2.6 Excursus Of Reasons Why M&A Operations Fail

What makes easy for an M&A process to fail is the difficulties faced during the process of integration: even if a company is easily acquirable, this does not mean that the final entity will work properly, especially if nothing has been done in order to facilitate the integration between components (in this case, human and technical resources).

The distinctive capacities of each firm, that make it unique and favorable to be acquired, are not single attitudes neither specific resources, but are a stratification of cultural approach within the company, competences gained during years of activity, intangible resources, that have to be carefully absorbed by the main company in order to maintain all the positive effect expected. Here, the integration process is strategical, crucial and extremely weak.

The critical factors that determine the fail of the process of value creation can be identified as a lack in management objectives and capabilities, absence of a clear strategy, the miss of key stakeholders involvement, weak integration of systems and culture, different expectations, lack of multifunctional teams, whereas the principal reasons that determine the failure could be grouped in the following: over pricing, over estimation of the target company acquired (in terms of market share and synergies), inadequate management of integration process.[48]

The factors mentioned above can be reconnected to two main groups of problems that the company may encounter during the process of M&A: problems arising in the process of decision making and problems linked with the process of integration. The first, concern a lack in strategic reflection and underestimation of the quality of the decision making process in terms of fragmentation in decisions (t.i., to contact different actors like banks,

[48] Jaquemin A., “Nuovi sviluppi di teoria dell`organizzazione industriale e implicazioni di politica della concorrenza”, l`industria n. 3, 2001

consultants, legal agents, instead of having one unique set of experts), the gradual increasing of push toward the conclusion of the agreement (especially by managers and stakeholders), and the ambiguity of expectations linked with the multitude of reasons that move the deal. On the other hand, problems linked with the process of integration concern determinism (t.i., to be stuck in the original reason for the deal, without changing opinion even when circumstances would require so), value erosion (the value that the main company wants to gain could be lost along the process if no attention is given to integration of resources and people), and absence of leadership that knows how to manage the process in the best way (a competence that many companies acquire during the years, especially after many M&A deals).

The process of M&A is supposed to produce value for both firms when they merger in the new one, but even if the background is good and the process has been taken in the right way it usually happens that the final step, the new entity, failed in its purpose: almost 75-80% of merging processes failed, not being able to achieve the ultimate goal of the synergy .

Facing skepticism and intense pressure to perform, managers overseeing the execution of these transactions tend to focus on quick wins. While supply chain efficiencies and operational improvements have a direct impact on the revenue, cost, capital expenditure, and working capital synergies that result from a merger, the experience indicates there are several missed opportunities in all phases of the merger process, from pre-deal planning through post-integration. There are many reasons why it happens, that can be recollected in three principals "why" companies fail to achieve mergers and acquisitions (M&A) operational, supply chain, and manufacturing operations synergies:

1. **Planning**: first, companies focus on capturing short-term financial synergies rather than taking a holistic view. By reducing the scope, they often overlook many “hidden” synergies and fail to create high performing supply chains with significant long-term upside that provide sustained value for customers and

stakeholders (t.i., overestimate, overpaying synergies and slow pace of integration);

2. **Preparation**: second, during M&A due diligence, companies overlook the overall business and operational “compatibility” of the two companies. Operational synergies are not synchronized with the customer/market needs of the combined entities, often requiring supply chain “rework” or savings “erosion”;

3. **Execution**: finally, companies underestimate the complexity, resources, communication, and management focus needed to execute a successful integration and realize expected synergies.

Most supply chain integrations typically extract short-term financial synergies efficiently, but fall short of creating high-performing supply chains. Supply chain integration should be planned or implemented only after having a clear definition and understanding of the business strategy for the new company and aligning the operating model with the business strategy.[49]

The major awareness of decision processes`importance represent the first walk toward problem solving and avoidance of value destruction. M&A deals represent an exam for each company that starts to arrange an agreement, and only few of them are able to give an happy ending to the story: those are the ones with a clear company vision, of competences owned and desired, resources, the roadmap that has to be followed in order to proceed in the right direction. Are the companies more inclined to change and adaptation, that are able to realize a “creative tension”between rationality, increment of value, behaviors and values.

Now a spontaneous question arises: why, if deals of M&A are so risky and have so high rate of failure, are organizations inclined to pursue them?

[49] Deloitte survey m&a operational synergies

The reason stands in the potential huge rewards available for the companies involved, their managers and the shareholders: all the potential benefits are always cited in the M&A announcements (new opportunities, economies of scale, growth and enhancing buying power). "Fit" is the term used to cover the overall attractiveness of the deal in terms of how the two firms would work together. Nonetheless, there could be also more complex reasons behind the choice: not all of the factors that influence the deal have to do with creation of value for the shareholders, not all of them will necessarily be in the shareholders' interests. Besides, in many countries is possible to see "shot-gun marriages" facilitated by central government or regulators (i.e., political reasons, macro-economic considerations; in those situation, the role of shareholders in surprisingly weak).

It has been suggested that many M&A deals could have failed because they were moved by interests that go beyond the shareholders' ones and needs, but were more self-interest.

From the *shareholder perspective*, him/her is concerned with the current and future performance and therefor value of their company, they look for ways to increase that value in either short term or over longer period, or ideally both.

The reality is that there are plenty of reasons why companies decide to merger/acquire, some moved by shareholders' interests, some not.

From the *managerial point of view*, we have to consider that in SME's management and ownership are closely linked. That's why usually the motivations of management and shareholders are more likely to be aligned (motivations such as maximize value, or individual control for family owned firms).

As corporations get larger, the distance between management and shareholders increase, and the first become employees of the seconds, in the sense that they'd have to improve the performance of the company in order to satisfy the needs and willing of shareholders even if may not always act in the shareholders' best interests. This cost to the shareholders is called agency cost. Self-interest (of managers) might cause management to promote the sale of the company that will best reward them and not the shareholder. These types of conflict of interests may cause management to:

- pursue a M&A strategy when an organic growth strategy might be more appropriate,
- select poorer acquisition targets,
- fail to create the expected value from a deal for shareholders,
- overestimate the value creation potential of a deal,
- overvalue a firm to be acquired or under-value their own company,
- incur unnecessary transaction costs,
- rush to make decisions with insufficient information which will drive longer term costs.

It is very difficult to understand which are the real motivations of managers, because they can easily justify their action and decisions in terms of value creation before and after the event.
Those are few self-interested reasons why management may decide to pursue a M&A strategy:

- job security (become bigger means potentially more expensive and difficult to be acquired, and less attractive; at the same time, it becomes less likely to suffer financial distress; diversification is a way to avoid/reduce risk, especially if the M&A involves completely different companies)
- management investment (the management are often highly invested in a firm through a multitude of factors like they draw their income from the firm, they may be paid bonuses, their pension is drawn from the firm, shares and options may be awarded)
- job enrichment (desire for self-fulfillment)

- reward (clear advantage to being a manager in a larger organization, that brings prestige, power and enhanced financial reward, seeing that the financial reward typically materializes even if there is no increase in the value of the firm (Jesen, 1986).

The presence of non-executive directors in the organization allows to reduce those risks of conflict. Additionally, holders of large blocks of equity are in a position to hold managers to account in a way that is not possible for small shareholders. Traditionally, large institutional shareholders such as fund managers have been reluctant to get directly involved in the running of companies they hold shares in.

The other source of counterbalance to risk of agency cost is the rising of activist investors. Finally, the market will, to a certain degree, reward or pushing management according to how well they use the resources available to them.

CHAPTER 3

SUMMARY: 3.1 Introduction; 3.2 International Financial Reporting Standards; 3.2.1 IFRS 3; 3.2.2 IAS 27; 3.2.3 IFRS 10; 3.3 Italian standards: the OIC principles; 3.3.1 The OIC 4

3.1 Introduction

Besides the strategical aspects that characterize M&A processes, we have to consider also the accounting implications of this operation.

The operation of M&A could be viewed both under the international and country standards point of view, depending on the kind of company that concludes the action. There are four cases in which the company is forced to use the International financial reporting standards, in particular: the companies that are listed on the stock exchange, banks and financial intermediaries, insurance companies that have to present the consolidated financial statement and listed insurance companies. In general, the listed companies are forced to prepare their financial statement under the IFRSs because that are under the control of international authorities and potential international investors, that thus need clear documents to understand the wealth of the company they want to invest in. All the companies that are not framed in this definition, are allowed to prepare the financial documents under the IFRS but are not forced to, so they can use the country of origin standards as well.

In this chapter i am going to describe the operation of M&A under the international and italian point of view, thus under the guidelines of IASB and the OIC (Organismo Italiano di Contabilità) to give a complete background for both listed and not companies.

Concerning the IFRS standards, I will expose IFRS 3, that gives a definition of business entity, IFRS 10, that considers the consolidated financial statement and IAS 27, that concerns the control issues rose by the new entity. In the last years, there has been a substantial convergence between contents of IAS 27 and IFRS 10, thus here i am going to present IAS 27 concerning the definition of control, while IFRS 10 concerning the procedure of consolidation of the financial statements.[50]

On the other side, i will give a general overview of the italian Principles as well, being the majority of italian companies small and medium enterprises, thus not necessarily using the IASB standards.

3.2 International Financial Reporting Standards

I have to mention, in order to avoid misunderstanding, that the actual version of the Principles has been reviewed and the revision process has rose many perplexities in the academic and professional world (the discussion roots around the implementation of FASB's and IASB's principles to create a common set of international standards, process that brought to the implementation of IFRS 3 in the direction of US-GAAP standard and this caused the starting of discussion process among different subject). The present work will consider only the implemented versions of IFRS 3 and IAS 27, not the previous ones, and will not focus on the discussion that is going on about the revised version of the Principles.

It is important, however, for the management, to consider the differences that new Standards bring, because they can lead to differences in the definition of the process and both the achievement of positive returns or not, having a real impact on the agreement. To be mentioned, two significant changes that occur with the adoption of the new IFRS 3: it reinforces the role of control over a company and exacerbates the disconnection between cash flow and accounting earnings, besides it prescribes the wider use of fair value

[50] Deloitte IFRS Global Office, "Business combinations and changes in ownership interests - a guide to the revised IFRS 3 and IAS 27", 8 July 2008

measurement in the post acquisition period (which is likely to add to earnings and equity volatility).

Even if the topic of the dissertation is not the changing process of IFRS 3, it is important to give a general overview of the concepts that majorly have been influenced: control and fair value.

Control, that before the modification was intended to be the control of one company over another, and the preparation of consolidated financial statement was from the parent company's perspective, the new Principle requires the adoption of an "economic entity" model. Thus, consolidated financial statements are throated as those of a single entity and prepared from the perspective of both majority and minority shareholders.

Two noteworthy consequences are referable to the influence that a change in control has on the recognition of a loss or a gain in the income statement, and when the acquisition or disposal of equity interests do not result in a change in control, the economic entity is perceived as intact.

3.2.1 IFRS 3

"*A transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as 'true mergers' or 'mergers of equals' are also business combinations as that term is used in this IFRS*". [51]It does not apply to: JV, acquisition of an asset or a group of assets that is not a business as defined and a combination of businesses under common control.

Business combination transaction follows the acquisition method composed by four main steps: [52]

1. identify acquirer

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[51] Following the definition of "Business Combination" gave by the IASB's IFRS 3

[52] http://www.iasplus.com/en/standards/ifrs/ifrs3

2. determine acquisition date
3. recognize and measure the identifiable assets
4. recognize and measure any goodwill or bargain purchase[53]

The first step throughout the process is the identification of the business combination: in order to cover the definition, the acquirer must obtain the control over the business combination.[54] Thus, there must be a triggering economic event or transaction and not, for example, merely a decision to start preparing combined or consolidated financial statements for an existing group (following IFRS 3 BC 10).

Economic events that might result in an entity obtaining control include:[55]

- transferring cash or other assets (including net assets that constitute a business);
- incurring liabilities;
- issuing equity instruments;
- a combination of the above;
- a transaction not involving consideration, such as a combination by contract alone.

There is a range of factors that could influence the structure of the business combination, including legal and tax strategies (besides, market and regulatory considerations play a certain role).

Examples of structures are:[56]

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53 Ghosh Ray Kamal, " Mergers and Acquisitions : Strategy, Valuation and Integration", Prentice Hall of India, New Delhi, 2010

54 Deloitte IFRS Global Office, op.cit

55 IFRS 3(2008).B5

56 IFRS 3(2008).B6

- one business becomes a subsidiary of another;
- two entities are legally merged into one entity;
- one entity transfers its net assets to another entity;
- an entity's owners transfer their equity interests to the owners of another entity;
- two or more entities transfer their net assets, or the owners transfer their equity interests, to a newly-formed entity (sometimes termed a 'roll-up' or 'put-together' transaction);
- a group of former owners of one entity obtains control of a combined entity.

Then, the identification of a business happens as following the IFRS 3, that states: "*An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants*". During this process of identification, the firm has to presume the value of the goodwill. Paragraph B12 provides an over-arching test based on the presence of goodwill: *'In the absence of evidence to the contrary, a particular set of assets and activities in which goodwill is present shall be presumed to be a business. However, a business need not have goodwill'.*

After the identification of the business, the Principle defines how to identify the acquirer. The acquirer and the acquiree are identified by applying the guidance in IAS 27 regarding the concept of control (I am going to analyze it in the next paragraph, here is just a mention).

Where identification is not achievable by this analysis, application guidance in IFRS 3.B14–B18 provides additional guidance, that are summed up in the following table.

Factor	**Acquirer is**
Consideration primarily cash, other assets or incurring liabilities.	Usually the entity that transfers the cash or other assets, or incurs the liabilities. [IFRS 3(2008).B14]
Consideration primarily in equity interests.	Usually the entity that issues its equity interests. However, in a reverse acquisition, the acquiree may issue equity interests (see chapter 14).

In addition, in the case of a share exchange, other pertinent facts and circumstances may be as follows:

Factor	Acquirer is
Relative voting rights in the combined entity after the combination.	Usually the entity whose owners as a group retain or receive the largest portion of the combined voting rights, after considering the existence of any unusual or special voting arrangements and options, warrants or convertible notes.
No majority interest in the combined entity, but single large minority interest.	Usually the entity whose single owner or group or organised voters holds the largest minority voting interest in the combined entity. Care should be taken in applying this test to ensure that the IAS 27 test of 'power to control' is met.
Composition of the governing body of the combined entity.	Usually the entity whose owners have the ability to elect or appoint a majority of the members of the governing body.
Senior management of the combined entity.	Usually the entity whose (former) management dominates the combined management.
Terms of the exchange of equity interests.	Usually the entity that pays a premium over pre-combination fair value of the other entity or entities.

The determination of the acquisition date is the next step, after the definition of business combination and acquirer: the acquisition date is the date on which the acquirer obtains control of the acquiree. [57]Generally, for IFRS 3, is the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree (thus the closing date).

[57] IFRS 3(2008)(Appendix A)

However, the acquirer can consider all pertinent facts and circumstances in identifying the acquisition date, and it might be that control is achieved on a date that is either earlier or later than the closing date (for example, the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date).[58]

Recognizing and measuring the acquired assets, assumed liabilities and non-controlling interests is fundamental. Informations about those kind of references are contained in sections 8.1, 8.2 and 8.3 of the IFRS 3. After the establishment of the principles, the IFRS 3 provides guidance to the application in case of specific assets and liabilities (referred to 8.4), and specific exceptions (referred to 8.5). First of all, the paragraph 10 states that the acquirer, at the date of acquisition, has to identify the values of assets, liabilities and non-controlling interests, separately from the goodwill. The acquirer makes those classifications or designations on the basis of contractual terms, economic conditions, its operating or accounting policies, and other pertinent conditions as they exist at the acquisition date.[59]

The Standard provides two exceptions to the principle that classifications or designations are based on the terms of instruments and conditions at the acquisition date. The two exceptions relate to:[60]

- the classification of a lease contract as either an operating lease or a finance lease in accordance with IAS 17 Leases;
- the classification of a contract as an insurance contract in accordance with IFRS 4 Insurance Contracts.

[58] IFRS 3(2008).9
[59] IFRS 3(2008).15
[60] IFRS 3(2008).17

As mentioned above, the value of assets acquired and liabilities assumed is determined at their fair value (an acquirer is not permitted to recognize a different valuation allowance than the acquisition date for assets acquired because the effects of uncertainty about future cash flows are included in the fair value measure).

The non-controlling interests valuation has two alternatives, attributable to fair value: the fair value itself, or the non-controlling interest's proportionate share of the acquiree's identifiable net assets. Where the option is taken to measure non-controlling interests at fair value (which is generally higher than the proportionate share of identified net assets), there is a corresponding impact on the residual amount of goodwill.

For the purpose of measuring non-controlling interests at fair value, it may be possible to determine the acquisition-date fair value on the basis of active market prices for the equity shares not held by the acquirer. When a market price for the equity shares is not available because the shares are not publicly traded, the acquirer should measure the fair value of the non-controlling interests using other valuation techniques.[61]

The fair values of the acquirer's interest in the acquiree and the non-controlling interest on a per- share basis may differ. The main difference is likely to be the inclusion of a control premium in the per-share fair value of the acquirer's interest in the acquiree or, conversely, the inclusion of a discount for lack of control in the per-share fair value of the non-controlling interest.[62] Subsequent changes in the fair value of the non-controlling interest are not recognised.

IFRS 3 includes a range of guidance on specific assets and liabilities measurement. Those specifications include: operating leases and intangible assets (the recognition and measurement of intangible assets has always been one of the difficult areas of IFRS 3 to apply in practice, valuation

[61] IFRS 3(2008).B44

[62] IFRS 3(2008).B45

practices have developed over time and their interpretation and implementation remains varied),[63]that are treated deep in the Principle.

Once the value has been defined, we can provide identifying and measuring considerations. The acquisition-date fair value is composed by the sum of:

- the assets transferred by the acquirer;
- the liabilities incurred by the acquirer to former owners of the acquiree;
- the equity interests issued by the acquirer.

The consideration transferred may include assets or liabilities of the acquirer with carrying amounts that differ from their fair values at the acquisition date (e.g. non-monetary assets or a business of the acquirer). If so, the acquirer should remeasure the transferred assets or liabilities to their fair values as of the acquisition date and recognise any resulting gains or losses in profit or loss.[64]

Recognising and measuring goodwill or a gain from a bargain purchase is one of the last step in the definition of the Principle.

Consideration transferred, amount of non-controlling interests, value of any previously-held equity interest in the acquiree, the fair value of the identifiable net assets of the acquiree, compose the fair value, their sum is the value that the acquirer will display as goodwill arising from the business combination.

The revised IFRS 3 introduced the option, for the buyer that operated less than 100% acquisition, to have the chance to chose to valuate the non-controlling interests (minority) as a proportion of share of the net identifiable assets (the so called “partial goodwill”), or either at the fair value (the so called “full goodwill”), thus recognizing the goodwill on the non-controlling share.

[63] IFRS 3. IE18-44

[64] IFRS 3(2008).38

What may influence an acquirer to choose between the two methods? The utilization of the full goodwill method increases the value of the equity at the acquisition date, and may also reduce the potential decrease in controlling parent equity, resulting from a subsequent bayou of the non-controlling interest. This method could be more suitable for companies that have a weak equity base and/or a high level of gearing. On the other hand, the use of full goodwill method may have couple of negative aspects: the valuation technique to define the fair value measurement for non-controlling interests can be complex, and any impairment charge is higher than under the partial goodwill method, impacting negatively on reported operating result. The choice is in the hands of the management that choose the more appropriate method considering the final goal.

Briefly, those next situations are the special ones that require a partly different treatment.

In a business combination in which the acquirer and the acquiree (or its former owners) exchange only equity interests, the fair value of the acquiree's equity interests may be more reliably measurable than the fair value of the acquirer's equity interests. If so, the acquirer should determine the amount of goodwill by using the fair value of the acquiree's equity interests rather than the fair value of the equity interests transferred.[65]

Paragraph 33 of IFRS 3(2008) also deals with the situation of a business combination in which no consideration is transferred. This could occur where the acquiree repurchases equity interests from other investors such that the acquirer's unchanged equity interest becomes a controlling interest, or a business combination achieved by contract alone.

In a business combination achieved without the transfer of consideration, goodwill is determined by using the acquisition-date fair value of the acquirer's

[65] IFRS 3(2008).33

interest in the acquiree (measured using a valuation technique) rather than the acquisition-date fair value of the consideration transferred.[66]

When two mutual entities combine, the entity identified as the acquirer gives member interests in itself in exchange for the member interests in the acquiree. Thus consideration is paid, but its fair value is not readily determinable by reference to a market. IFRS 3 recognises that it may be easier to fair value the entire member interest of the acquiree, rather than the incremental member interests given by the acquirer.

Lastly, IFRS 3 permits adjustments to items recognised in the original accounting for a business combination, for a maximum of one year after the acquisition date, where new information about facts and circumstances existing at the acquisition date is obtained. Any such adjustments are made retrospectively as if those adjustments had been made at the acquisition date. Accordingly, any changes in fair value may result in volatility because of the impact that those future events could have on the income statement.[67]

The discussion upon IFRS 3 could be deeper and more detailed, as this dissertation only presents the general points that are recognized as focal by the Authority. For a more exhaustive explanation of each step, refer to IFRS3 text by IASB.

[66] IFRS 3(2008).33

[67] PWC Report "New IFRS Acquisitions (M&A)", Executive summary

3.2.2 IAS 27

In the previous section we talked about the business combination as explained by IFRS 3. Now, we analyze the guidelines by IAS 27 (that concerns the Consolidated and Separate Financial Statements) about the recognition of who has the power to govern the financial and operating policies of an entity in order to obtain benefits (where operating policies are activities such as: marketing, sales, human resources, acquisitions and investments, while financial policies are, for example: dividend policies, budget approvals, credit terms, issue of debt, cash management, capital expenditure and accounting policies). [68]

The concept of control in itself encompasses both benefits and risks of the governance (identified as power to make decisions). In a situation where one entity has the power to govern another one`s policies, but does not derive benefits from this activities, there is the presumption that control does not exist.

Control is presumed to exist when the major company owns at least half of the voting power of an entity. However, there are exceptions to this definition, circumstances in which control exists even if parent owns less than half of the voting power:

- power over more than half of the voting rights by virtue of an agreement with other investors;
- power to govern the financial and operating policies of the entity under a statute or an agreement;
- power to appoint or remove the majority of the members of the board of directors or equivalent governing body and control of the entity is by that board or body;

[68] http://www.iasplus.com/en/projects/completed/consol/ias-27-equity-method-in-separate-financial-statements

- power to cast the majority of votes at meetings of the board of directors or equivalent governing body and control of the entity is by that board or body.

In the circumstance in which two entities have joint control established by agreement, the arrangement will be under IAS 31, not IAS 27 nor IFRS 3.
One entity, through instruments such as share warrants, share call option, debt or equity instruments convertible into ordinary shares, could have the chance to enlarge its voting power or reduce the other entity`s voting power. This circumstance is called “potential voting rights”. Those are considered when the major control power of one entity is assessed, except when those rights are exercisable or convertible until a future event or date (IAS 27.14).

3.2.3 IFRS 10

The objective of IFRS 10 is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.
The Standard:

- requires a parent entity (an entity that controls one or more other entities) to present consolidated financial statements;
- defines the principle of control, and establishes control as the basis for consolidation;
- set out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee;
- sets out the accounting requirements for the preparation of consolidated financial statements;
- defines an investment entity and sets out an exception to consolidating particular subsidiaries of an investment entity.

When companies merger, they have to create a unique set of financial document, the consolidated financial statement has to follow certain rules of consolidation.[69]

Consolidated financial statements:

- combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries;

[69] IFRS 10:B86
IFRS 10:B88
IFRS 10:B92
IFRS 10:B93

- offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary (IFRS 3 Business Combinations explains how to account for any related goodwill);
- eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full).

A reporting entity includes the income and expenses of a subsidiary in the consolidated financial statements from the date it gains control until the date when the reporting entity ceases to control the subsidiary. Income and expenses of the subsidiary are based on the amounts of the assets and liabilities recognised in the consolidated financial statements at the acquisition date.

The parent and subsidiaries are required to have the same reporting dates, or consolidation based on additional financial information prepared by subsidiary, unless impracticable. Where impracticable, the most recent financial statements of the subsidiary are used, adjusted for the effects of significant transactions or events between the reporting dates of the subsidiary and consolidated financial statements. The difference between the date of the subsidiary's financial statements and that of the consolidated financial statements shall be no more than three months.

3.3 Italian Standards: The OIC Principles

The italian context identifies two principles in line with the ones of the IASB (to give a comparison just about few similar Standards, ndr): the OIC 4 about merger and demerger processes, and the OIC 17 about consolidated financial statement.

The first one gives and overview of accounting and organizational rules and principles to be followed when the company approaches the operations of merger, in order not to enter in collision with the Civil Law. The italian law does not have a specific discipline about the different cases in which two companies under the same control merger or reorganize their structure, and the case in which completely independent companies merger, so the Principle is applied to both situations.

As mentioned above, talking about the international accounting standards, those are mandatory for a specific group of companies (t.i., listed ones and insurance ones), while is complementary for the other companies. Thus, all the enterprises that do not enter in the above definition, are allowed to use the italian accounting standards.

The OIC 17 concerns the consolidated statement and gives the guidelines not to enter in collision with the italian Law. Besides, in order to follow the basic principle of giving to the reader the most clear information about the activity of the company, it explain how to correctly prepare a consolidated statement following the accounting standards.

3.3.1 The OIC 4

The first part of the text gives a general overview of the merger definition, framing it describing the characterizing nature and effects. Having already treated this theme, i will not spend many words on this. [70]

The Principle identifies three typical shades under the general concept of “merger”: the pure acquisition of a company in order to gain its know how, or obtain strategical advantages, with a dominant subject; the restructuring of two companies; the unification of two companies that share the management of the new entity without one controlling the other. The results that can be obtained through the merger of two companies under the juridical point of view are different: the “extinction” of the merged companies, that is linked with the birth of a new entity; the transfer to the new entity of the companies' equity and juridical relationships; the conversion of stakeholders’ participations or shares into new equivalent ones related to the new entity, and consequently the cancellation of the old ones. Here, the economic value of those participations is computed by the so called “change rate” (in italian, "*rapporto di cambio*") which represents the equivalent value of shares in the new entity, compared to the old ones. There are particular circumstances in which the change rate is not applied, for example if the partner of the acquiring company is unique, or when the two companies have the same associates.

Talking about the civil and fiscal law, and the juridical process of merger, we have to consider the Civil Law.

The process of merger is disciplined by Articles 2501-2505 *quater* of the Civil

[70] The following paragraph contaigns information refered to the approved text of OIC 4 - Merger and acquisition, January 2007, of the Organismo Italiano di Contabilità 2007-01-24_OIC-4_Fusione-e-scissione.pdf

Law as follows:

1. the disposition, by the subjects involved in the process, of the following documents:
   - the merger plan (*art 2501 ter)*
   - the financial statements of both companies that take part in the merger process (*art. 2501 quarter*)
   - the Relation of administrative organism that explains and justifies the project, in particular (where it is applied) the "change rate"indicating the criteria adopted for the conversion (*art. 2501 quinquies*)
2. a document, by independent experts, in relation to the adequacy of this change rate (*art. 2501 sexies*)
3. deposit of all documentation (*art. 2501 septies*)
4. the companies involved have to approve the merger project under the guidelines gave by the *article 2502* of the Civil Law
5. practical execution of the merger plan, thus undertaking the path (*artt. 2503 and 2504*). From the day in which the document is written in the Companies registration Office, 60 days have to pass before the merger process becomes active. After those 60 days, the merger act is stipulated and undertaken by shareholders of the two companies.

The *article 2504* states that the merger agreement has to be public, and has to be deposited at the Companies registration Office of the city where the new entity has a quarter and the two participating companies as well, within 30 days.

Talking about the effects that the merger process has, the rights and duties of companies participating in have to consider, we can refer to *article 2504 bis* of the Civil Law.

When we talk about merger and acquisition, it is not possible to avoid talking about the fiscal consequences that those operations provoke, because sometimes it is the research of fiscal gains that push companies in agreeing for the agreement.

The topic is disciplined by the *article 172 of the T.U.I.R*, the Italian Income Tax Code.

From the date in which the new entity is effectively active, all the duties and rights of the old companies pass to her, including the ones relative to taxation. In particular, *art. 172* defines the following aspects:

- neutrality of participating companies and associates,
- how to build the tax-suspension reserve,
- how to relate fiscal loss to the new entity,
- how to determine the inter-annual income

Just to give a brief explanation of the above cited aspects, without presumption of exhaustive definition, here below some clarifications that may help to better understand and appreciate the italian legislation concerning income taxation and related merger consequences.

3.3.1.1 NEUTRALITY OF PARTICIPATING COMPANIES AND ASSOCIATES[71]

The comma 1 of art. 172 ratifies the merger operations fiscal neutrality, underlying that those do not represent a realization nor a distribution of capital gains and capital losses. Thus, the gains that derive from the merger operation are not relevant nor depreciable from the fiscal point of view. This causes a different way of manage the process, from a fiscal and accounting point of view, that has to be mentioned in the apposite raw of the income tax.

[71] Refers to the paragraph "Normativa civilistica, fiscale (cenni) e procedimenti di fusione" of OIC4, p.9

Moreover, the Article states that the change of original participations with the ones of the new entity does not constitute fulfillment nor distribution of gains or losses, neither constitutes gains for the associates of the merged companies. It is irrelevant, from the fiscal point of view, the value of exchanged shares.

3.3.1.2 HOW TO BUILD THE TAX-SUSPENSION RESERVE[72]

The comma 5 of the art. 172 treats the tax-suspension reserve, that could be of two types:

1. always taxable reserve, if the reserve is not reconstitute in the first financial statement after the merger
2. tax-suspension reserve taxable only is they are distributed.

The rebuild of reserve will have to be through the merger surplus or when an increase in equity capital will be decided.

3.3.1.2 HOW TO RELATE FISCAL LOSSES TO THE NEW ENTITY[73]

The comma 7 of the article 172 allows the ratification of fiscal losses to the new entity only if the companies merging are “operative”. This means that gains and revenues of the characterizing activity and working expenditures of the companies involved, have to be equal or major to 40% of the average of the two exercises previous the merger. Besides, the losses are referable only to the part that does not exceed the value of the equity of the last financial statement, or, if minor, from the balance sheet considered in art. 2501 quarter

[72] Refers to the paragraph "Normativa civilistica, fiscale (cenni) e procedimenti di fusione" of OIC4, p.9

[73] Refers to the paragraph "Normativa civilistica, fiscale (cenni) e procedimenti di fusione" of OIC4, p.10

without considering provisions and deposits done in the last 24 months previous the date of the document.

The art. 35 D.L. n. 223/06 has extended those rules to backdated mergers as well, in order to eliminate the advantage that could be obtained by compensations.

3.3.1.3 HOW TO DETERMINE THE INTER-ANNUAL INCOME[74]

The comma 8 of the art. 172 considers how to determine the income in the period between the start of fiscal year and the date of effective merger, because this period is identified as autonomous fiscal period. The income is determined by an apposite revenue account and is subject to a specific income declaration.

Nevertheless, if there is a merger through incorporation, if in the merger act the fiscal and accounting effect are not referred to a previous date than the merging one, it will not be necessary to present the income declaration for the period in between. From this chance, it rises the habit of backdating the merger at 1 January (or the day of new fiscal year).

[74] Refers to the paragraph "Normativa civilistica, fiscale (cenni) e procedimenti di fusione" of OIC4, p.10

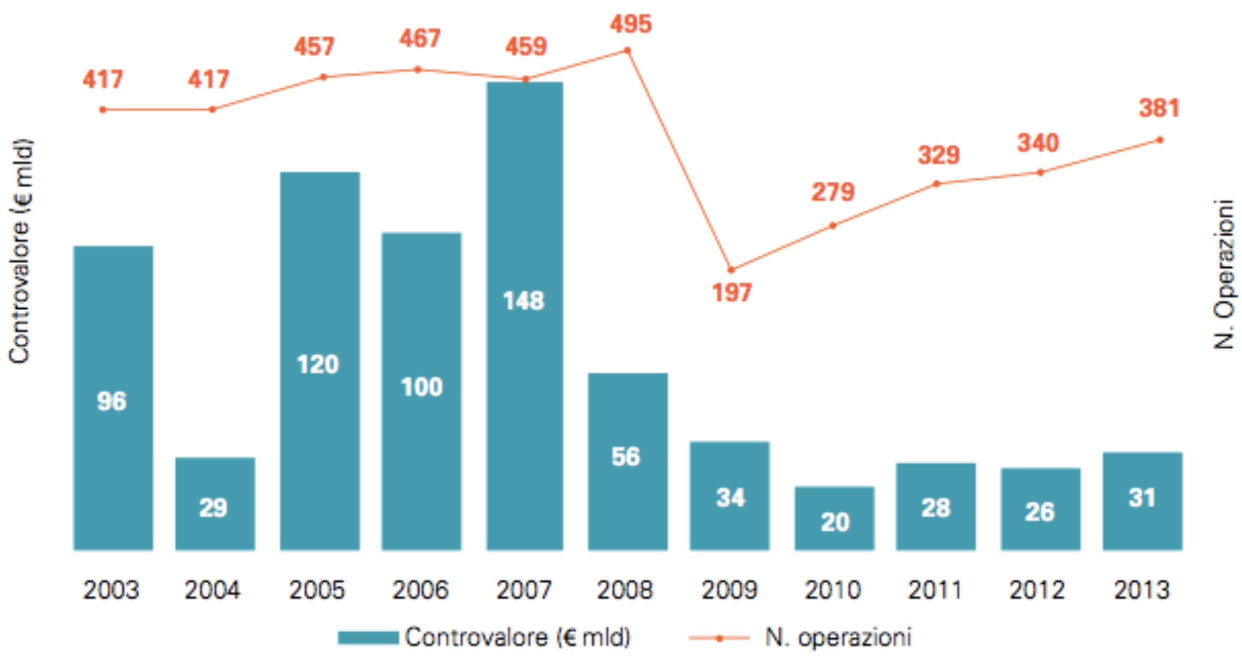
CHAPTER 4

SUMMARY: 4.1 Historical trends and overview of the italian M&A market; 4.1.1 Energy & Utilities; 4.1.2 Industrial markets; 4.1.3 Customer markets; 4.2 The Campari Group Case: history of a multinational and multi-brand italian company; 4.2.1 Acquisition of Forty Creek Distilled LTD; 4.2.1.1 Strategic rationale behind the acquisition; 4.2.2 Acquisition of Averna Group; 4.2.2.1 Strategic rationale behind the acquisition

4.1 Historical Trends And Overview Of The Italian M&A Market

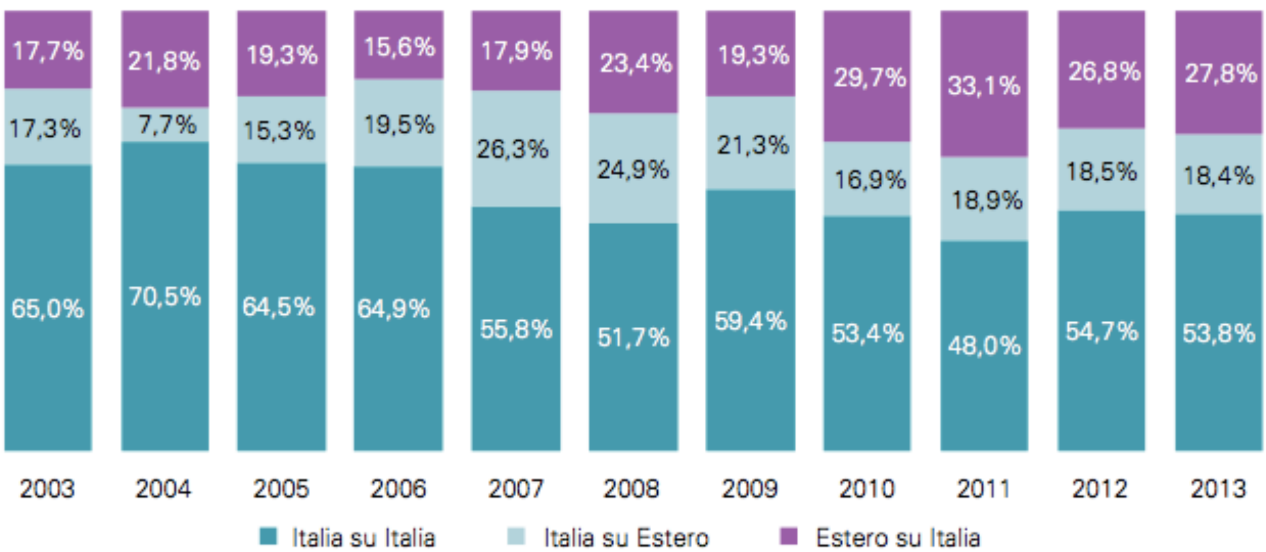
The aim of this dissertation is to give clues to the reader about the M&A market in Italy, the characteristics of this instrument and the implications that it has on the economy, considering the different sectors in which it is accomplished. Thus here I am going to present a rapid overview of the M&A market in Italy, with the major trends of the sector. [75]

The informations provided come from studies of KPMG Advisory S.p.a.. I will present many data tables with the aim of giving a concrete screenshot of the market, to appreciate the evolution and the perspectives.



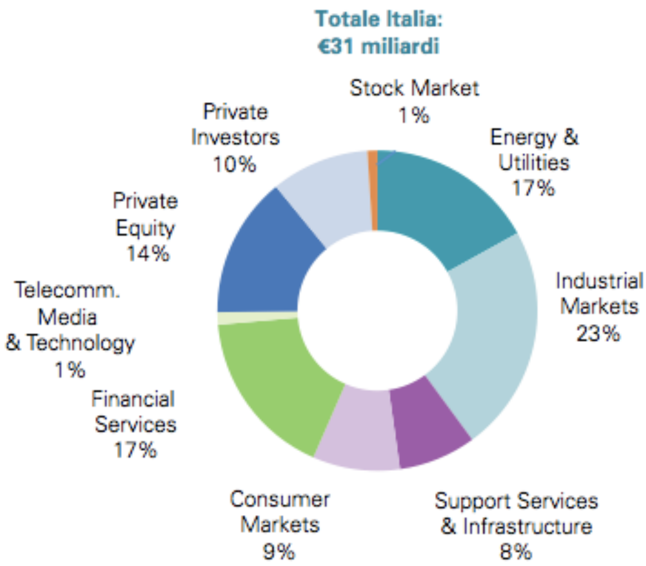
It could be useful to start with a graph that gives the overall idea of the M&A value in Italy. In general, it is possible to notice a decreasing in both number of deals and relative value during the years of the financial crisis, difficult period in which the focus was on surviving and maintaining the activity, more than being active on the market through M&A, even if few operation happened. In the recent years, the value of completed operation is still stable, whereas the quantity of them has constantly increased, denoting an ongoing trust within the market and courage of action, usually between SMEs that, in order to react faster, decide to merger.

The composition of the deals is very fragmented: the general growth has been double digit, exception made for small size deals that increase less, generating an average value of Euro 81 million. It is interesting to notice that both foreign transactions in Italy, and italian transactions abroad have increased (generating Euro 17.4 billion for 176 deals), while internet activities dropped of 20% from 64% of total market value in 2012 to 44% in 2013.



If we consider this percentage values together with the consistency value, it is possible to observe a decreasing in domestic deals, whereas the foreign operation gained ground reflecting a value of Euro 4.1 billion of italian operations abroad and Euro 13.3 billion in foreign deals in Italy.

Proceeding with an analysis of the deals from a macro perspective point of view, the sector that contributed the most as a bidder was the industrial one, both in terms of value (Euro 7,2 billion) and volume (24% of total deals), followed by energy and utility, and financial services, accounting 17% of total volume of deal, and then investments (made by private equity) came third with 14% contribution in the M&A market.



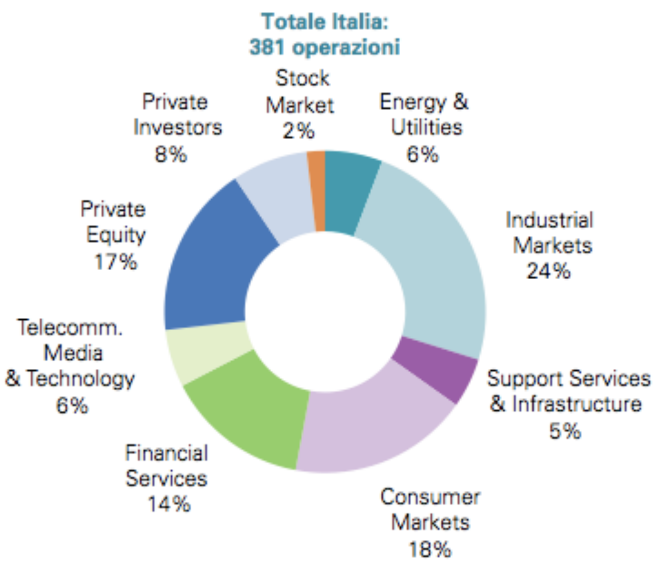


Table indicating the value of the bidder companies active in M&A

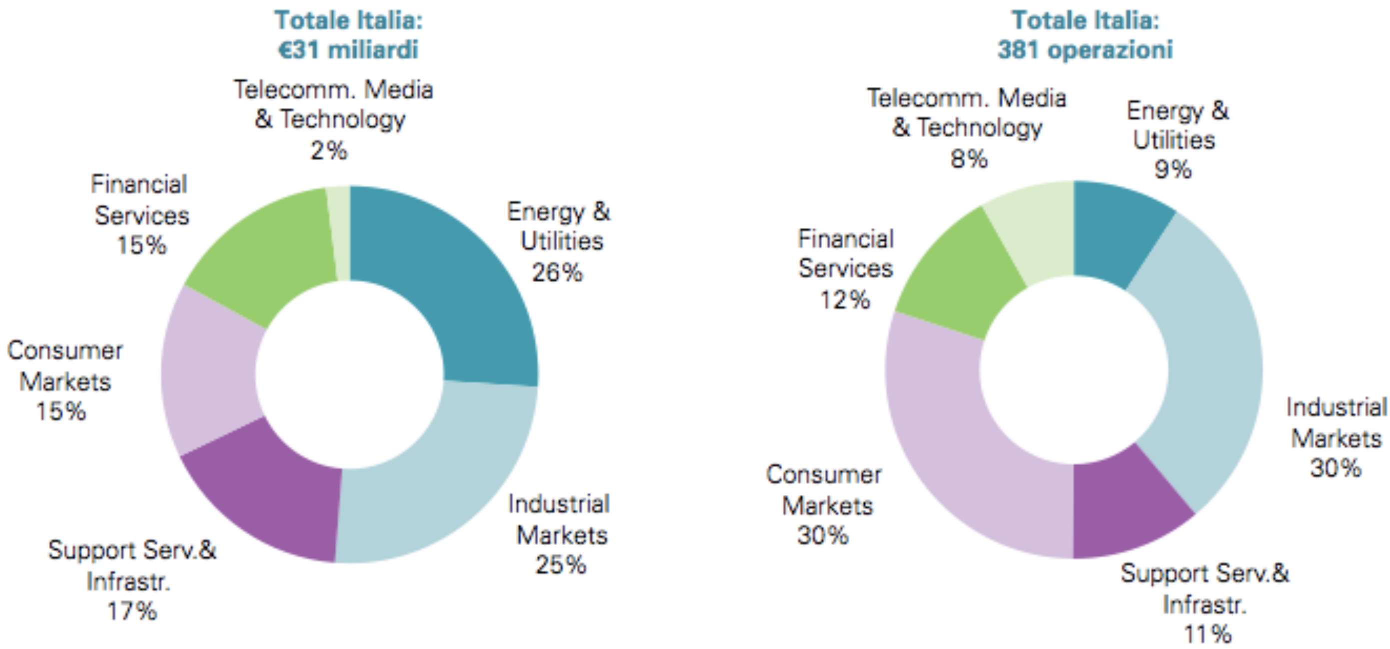


Table indication the value of the target companies active in M&A

The analysis of the impact of the target`s macro sector, in terms of accounting on the total M&A deals, demonstrates that the most active sectors to be targeted were Utilities & energy, industrial market and support services & infrastructure, while in terms of contribution to the total number of deals, a relevant part has been plaid by customer markets and industrial markets.

Combining those information, we can observe how energy & utilities and industrial markets have been the most active sectors both as bidder and target, being the top contributors in terms of value.

A brief analysis of mergers and acquisitions in 2013 in the most relevant macro sector follows.

4.1.1 Energy&Utilities

Many deals generated a total amount of Euro 8,0 billion, contributing the most to italian M&A activity. The various acquisitions that occurred in this sector were led mainly by strategic enlargement finalized in acquiring resources, knowledge and market share. This sector is a typical example of both horizontal and vertical integration: the consortium composed by Snam (45%), Singapore sovereign fund GIC (35%) and EDF Electricite'de France(20%), acquired the entire stake of TIGF Transport et Infrastructure Gaz France from Total, aiming at develop a strategic platform that connect the French and Spanish markets with those of Central and Northern Europe, integrating different tiers into one unique plan. Another example is ERG that become the largest wind operator in Italy after the acquisition of 80% of IP Maestrale Group (GDF Suez SA`s business unit owning wind plants in Germany and Italy).
Those cases represent examples of what we saw above during the chapter, giving a tangible view of how the market works (and why). [76]

4.1.2 Industrial Markets

It has been the second contributor to the italian market in terms of value, accounting Euro 7.8 billion with a growth of 204% from the previous year. The top deal in terms of value was Salini Spa`s acquisition of Impregilo Spa in the final establishment of Salini Impregilo group: the two companies act in the construction and engineering sector, realizing metro stations, airports, train stations, dykes, and major infrastructures & public works. The aim was to create a strong group that can compete at international level with the major players of the industry: it is a clear example of horizontal merger between two

[76] KPMG Advisory, "Rapporto Mergers & Acquisitions - in cerca di una direzione: il mercato aspetta segnali di ripresa", p.129, Corporate Finance, 2012

companies in the same field, that chose to integrate their activities, knowledge and network to enhance their business.

Foreigners acquiring companies in Italy concentrated their attention mainly on the excellences of technologies: General Electric acquired, through its subsidiary Nuovo Pignone Holding Spa, the civil and military engines division of Avio Spa (now Avio Aero). The acquisition furthers General Electric's participation and expertise in the areas of mechanical transmission systems, low-pressure turbines, combustion technology, and automation systems, and as counterpart, GE will pursue opportunities for Avio Aero in power-generation, oil, and marine products. "*Avio Aero operates in four continents and enhances our global capabilities and engineering strength as our production rates rise,*" said David Joyce, president and CEO of GE Aviation, "*Also GE will build Avio Aero's position as a supplier to other industrial and aviation companies. We are thrilled to further our industrial participation in Italy*". Avio Aero customers will benefit from GE's planned investment in these operations to expand their products and services. Additionally, GE sees excellent opportunity in the acquisition of Avio Aero related to margin expansion.[77]

Another important acquisition led by a foreign company has been made by Mohawk Industries Inc (one of the largest manufacturers of floor covering products for residential and commercial applications) of Marazzi Group Srl (specialist in ceramic tile). In commenting on the closing, Jeffrey S. Lorberbaum, Mohawk's Chairman and CEO, stated, "*The Marazzi acquisition continues the expansion of Mohawk's global business and will make us an even stronger company. Marazzi's innovative products, leading-edge designs, efficient manufacturing and excellent service have created one of the industry's most valuable brands. With the combination, we have many opportunities to improve our ceramic performance by leveraging best practices, operational expertise, product innovation and manufacturing assets across the enterprise*

[77] http://www.geaviation.com/press/other/other_20130801.html

Press center General Electric, August 2013

(…) The addition of Marazzi will allow us to expand our U.S. distribution, source ceramic tile from our worldwide base, and provide industry leading innovation and design to all of our global ceramic customers. With our solid financial position, manufacturing and distribution expertise, and international participation in all flooring categories, Mohawk is positioned for long term growth to maximize shareholder value."[78]

Also from the point of view of italian companies acquiring or merging abroad there has been an increasing on the previous year. in particular, with reference to the automotive sector, particularly active was Fiat Group: in addition to the investment in Chrysler, was completed the integration between Fiat Industrial and its subsidiary CNH Global NV, the Holland agricultural and earthmoving machineries manufacturer. The merger led to the creation of a leading capital goods company with a well diversified portfolio and coverage all around the world. This deal was based on a kind of diversification to strengthen the business of Fiat Group and its galaxy.

Another deal in the automotive sector was made by the private equity fund Investindustrial Spa that gained 37.5% of Aston Martin Lagonda Ltd, to enhance the investments in the renewal of the range of products offered by Aston Martin and accelerate its geographical diversification strategy in relevant markets.

This is more a conglomerate example of deal, in which the private equity bought the quote of capital of the company, that in itself is not acting in the same sector as Investindustrial Spa. The private equity is a particular subject that acquires companies to restructure and resell the company, or give the necessary capital and financial resources to complete a strategy of growth.

Finally, a mention has to be done also about Fincantieri Spa's acquisition of 55.6% of the capital of STX OSV AS form the korean conglomerates STX Europe. The operation on the Norwegian company world leader in the

[78] Press center Mohawk, April 2013
http://mohawkind.com/CorporateIRMarazzi.aspx

construction of means of support for extraction and production of oil and natural gas, will enable Fincantieri to enter into a complementary market versus those in which it already operates. With 21 shipyards in 3 different continents, nearly 20,000 employees and revenues of Euro 4 billion, Fincantieri Group will double its size to become the fifth largest shipbuilder worldwide behind four Korean peers, and the only Western producer capable of competing with the Asian giants thanks to its diversification and presence in all of the high value added segments.[79] This deal is a clear example of diversification through vertical acquisition.

4.1.3 Customer Markets

The customer market is the first, in terms of volume, in the M&A market, with 114 deals completed (in terms of value it accounts for 15% of total M&A with Euro 4.8 billion in 2013, +24% on 2012). In 2013 the trend of italian firms as target or bidder for acquisitions has been confirmed: the companies operating in the Made in Italy sectors were once again the most numerous. [80]

Foreign operations on italian companies were significant in term of value: just to mention a few, LVMH on Loro Piana Spa for Euro 2.0 billion, and after the smaller one involving Cova Montenapoleone Srl; the passage of Pomellato Spa to Kering for Euro 0.7 billion.

[79] Press center Fincantieri Spa, January 2013 https://www.fincantieri.it/cms/data/browse/cef/000013.aspx

[80] KPMG Advisory, "Rapporto Mergers & Acquisitions - in cerca di una direzione: il mercato aspetta segnali di ripresa", p.122 and following, Corporate Finance, 2012

Other remarkable operations happened in the food industry: the acquisition by the spanish Ebro Food SA of Riso Scotti, to enhance the growth on foreign market and specialize in risotto manufacturing; the sweet brand Pernigotti was sold to the turkish family group Toksöz through its subsidiary Sanset Gida Turizm Sanayi Ve Ticaret AS. In the customer good sector, the kitchen manufacturer Berloni, subject to an arrangement with creditors, has been acquired by the Taiwan group HoCheng for 50%, 44% by Intermedia Holding (Giovanni Consorte's merchant bank) and the Berloni brothers for the residual 6%.

Target	Bidder	Nazione Bidder	Quota	Valore € mln	Anno
Bulgari SpA	LVMH Moët Hennessy Louis Vuitton SA	Francia	100,0%	4.300	2011
Loro Piana SpA	LVMH Moët Hennessy Louis Vuitton SA	Francia	80,0%	2.000	2013
Valentino Fashion Group SpA	Permira	UK	87,6%	2.271	2007
Gruppo COIN SpA	BC Partners	UK	100,0%	930	2011
Valentino Fashion Group SpA	Mayhoola for Investment Spc	Qatar	100,0%	700	2012
Moncler SpA	Eurazeo	Francia	45,0%	418	2011
Moncler SpA	Carlyle Group	USA	48,0%	400	2008
Pomellato SpA	Kering SA	Francia	81,0%	350	2013
Fila SpA	Sport Brand International (Fondo Cerberus)	USA	100,0%	326	2003
Fendi	LVMH Moët Hennessy Louis Vuitton SA	Francia	25,5%	295	2001
Bulgari SpA	Singapore Investment Corporation Pte Ltd (Governo di Singapore)	Singapore	0,8%	238	2001
Brioni SpA	PPR Pinault Printemps Redoute SA	Francia	100,0%	218	2012
Marcolin SpA	PAI Partners Sas	Francia	78,6%	208	2012
La Rinascente Srl	Central Retail Corporation	Thailandia	100,0%	205	2011
Conbipel SpA	Oaktree Capital Management	USA	100,0%	200	2007
Gruppo COIN SpA	Bellini Investimenti (PAI Partners)	Francia	62,9%	181	2005
Ferretti SpA	Shandong Heavy Industry Group Ltd	Cina	75,0%	178	2012
La Perla SpA	JH Partners LLC	USA	70,0%	160	2007
Jeckerson SpA	Stirling Square Capital Partners, Sirius Equity	UK	100,0%	125	2008
Antichi Pellettieri Bags SpA	3i Plc	UK	49,0%	118	2008

The domestic deals kept the majority of the market, in term of numbers. To be mentioned the acquisition of 36% of Salmoiraghi e Viganò srl by Luxottica, that

with this deal gains direct sales force on the market through the retails of the italian brand, enhancing its distribution channel.
Again, Luxottica, Marcolin, Loro Piana, Recordati Spa, represent just few names of active companies on the market that enlarge their action abroad through operations of merger and acquisition of other companies in order to strengthen their core business, enlarge their capabilities, diversify the market, enter new target.
One problem of italian SMEs is that they are not able to come together and join their huge potential to expand their influence abroad. Acquisition completed in Italy by large international companies are aimed at creating those large luxury platforms which italian companies, as said, have failed to set up so far by combining the domestic brands (clustering of firms is not enough to create a unique reality, entity, it is necessary to involve a major company that could swallow all the small excellences in the territory).
This failure to coordinate and join forces among the italian system`s brands prevents companies from reaching that critical mass and cash flow optimization which are required to compete successfully in a global market. Acquisitions or mergers are not the only possible solution to enrich the profitability of a series of companies: to create a network that gives a fast and exhaustive answer to needs, is another way to improve efficiency and leverage on local knowledge.The luxury sector is not the only one to incur in many M&A operations; also the food and beverage one is active, here finding positive examples of italian companies hugely active at international level through strategical acquisitions.
One best-in-class actor is Campari Group, the one that i chose to present in the dissertation.
In the next few paragraphs i will tell the story of this important italian brand, underlining its acquisition strategy and the reasons that led to this kind of internationalization choice.

Campari is an historical italian brand, well known for the extraordinary expansion that is had (and still has) over years, and the quality of its products.

4.2 The Campari Group Case: History Of A Multinational And Multi-Brand Italian Company

Srating with a general overview of the company, Campari group has a long story, that begun in 1860 in Sesto San Giovanni and during the years has spread its presence all over the world enlarging the boundaries of the company from Italy to the Far East, becoming the sixth- largest player in the premium spirits industry. The Group has in its portfolio more than 50 brands (including the well known Aperol, Skyy, Lemonsoda family). [81]

Today the Sesto San Giovanni firm owns 16 plants and 3 wineries world wide, and has its own distribution channel in 19 countries employing more than 4000 people.

The first important revolution in the Group happened in 1932, when Davide Campari created the first single-served aperitif, the Campari Soda, which become the winning product of the brand and around it was created a deep marketing strategy, intelligent, to push the novel product.

In the Sixties, the distribution power was already reaching over 80 countries, an avant-garde pioneer for future generations of entrepreneurs, that explored foreign markets and got the point, reaching extraordinary results results. The forecasting and adaptation capabilities, together with strong values awareness and brand knowledge, allowed the company to gain a huge amount of positive returns on investments.

In the second half of the Nineties, the beverage industry has been characterized by a strong M&A's trend which led to the creation of corporates with global dimensions and remarkable portfolio's articulations.

[81] All this paragraph refers to official documents found in the corporate section of the Campari Group website, concerning investors relation and governance. Only official documents have been used, no other references. Everithing in this section is contained in the Relations of the Group.

Therefore Campari chooses to expand not only via organic growth but also via external growth, turning from a single brand company to a multinational company with a solid portfolio, well endowed and orientated towards an international expansion.

Focusing on organic growth means on the internal activities, the development of effective mechanisms that end up in growth of the core business. It is a good indicator of how well the management has used the internal resources available generating a positive return and increasing the profitability of the company.

External growth, by contrast, identify a process of expansion and positive returns from investments made outside the company, so through direct investments, acquisitions or partnerships.

"Gruppo Campari strives to grow and maintain its market share by positioning and promoting its brands clearly and consistently across all their markets. The Group's main marketing objective is to devise a clear, distinctive and enduring strategy to build, increase the visibility of and develop each of the Group's products as a premium, dynamic and contemporary brand across diverse international markets, usage occasions and consumer audiences. Campari Group invested € 249.2 million in advertising and promotion in 2013.

A key driver of the growth strategy is innovation, including the development of new products, line extensions and/or the re-launch of existing products. The Group has a strong history of re-launching and developing acquired brands.[82]"

Gruppo Campari's growth strategy aims to combine organic growth through strong brand building with shareholder value enhancing acquisitions.[83] Spirits are the company's core business and where it focuses its acquisition efforts.

The group's strategic thinking is driven by the desire to reach or enhance critical mass in key geographic markets.

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[82] http://www.camparigroup.com/en/our-group/strategy/strategic-guidelines

[83] http://www.camparigroup.com/sites/default/files/downloadspage/160614gruppocamparipreseng_new_2q.pdf

Marketing and brand building are key as Gruppo Campari considers its brand portfolio to be its key asset.
To sum up the focuses on which Campari Group pushes, here below a rapid overview:

ORGANIC GROWTH	**EXTERNAL GROWTH**
Drive faster growth of key international and regional brands with best-in-class marketing and innovation	Seek acquisitions in markets where Campari group controls its distribution
Generate steady growth in key local brands through periodical renewals	Acquire local brands with strong equity to build new distribution platforms
Develop the Group's presence in emerging markets	Generate synergies by acquiring new agency brands
Leverage a rigorous cost discipline so as t reinvest savings into strategic brand building	Maintain financial discipline

It is clear a rigorous strategy that lays under all the steps the management did: an attention to costs, focus on financial discipline and control, to prevent negative returns on investments and problems in future. All the actions taken most be solidly covered by financial stability and security, and pay a return that could justify the investment in itself. The values of the company, integrity, passion, pragmatism and performance orientation, perfectly fit in the strategy adopted by the company and its relation on results to improve the investments in the core activity.
The strategy of Campari has been to expand abroad into complementary segments (spirits industry) that can enlarge and enrich its offer to the market, covering different segments and targets (from non alcoholic drinks, to whiskeys and vodka). The very brilliant strategy adopted allowed to enter new markets through the acquisitions of medium companies, well known in their territories, that could be a useful investment both in term of know-how acquired and financial. Another action to be pointed out is the listing on the Milan Stock

Exchange in 2001, that implemented the flow of financial resources invested in core activities and both external ones.

The market into which Campari Group operates is featured few big global actors that manage many brands, and a multitude of medium-small firms that operate in niche markets, this is a distinctive trait that characterizes the industry along the last 15 years.

The key moment that gave the start to the transformation from a single market to a global Group, happened during the Nineties, years in which the environment was characterized by strong concentration policies, with companies acquiring other smaller ones becoming multinational and structured with a vary portfolio of brands, operations that led to changes into the alcoholic beverage sector. The key element of the Campari group policy has been to acquire companies, and to leave them the free to act with autonomy: the company, indeed, renounces to centralize the control, in order to guarantee the freedom of action to the new acquired corporations, without collide with the values and mission of the Group. So, full autonomy, framed by common mission and value (plus, of course, a continuous yet not invasive process of control).

The first acquisition was made in 1995: Dutch Group BobWessanen, that had in its portfolio brads like Crodino, Cynar, Lemonsoda, Biancosarti and Crodo, and was a way to consolidate the core business entering the soft drink market.

After this first operation, another critical step in the growth strategy was the acquisition of Cinzano and Ouro12, that allowed to enter new markets (Greece) and acquire knowledge in the sector of wine.

In 2001, the brand Skyy Spirits LLC has been acquired, and become entirely owned by Campari within 2006, representing the entrance in the Russian market and its vodka segment. At the beginning, it was a minority acquisition and distribution strategic alliance with Skyy Spirit Llc, that had the chance to distribute Campari products in the USA, allowing Campari Group to take advantage of its channel distribution.

This step allowed the Group to acquire a strong position into the emerging market, gaining advantage in the knowledge that the local brand already had on specific customers. Here, the tactic to acquire a potential partner is evident, and also the benefits from this operation. The intelligence of the Group is again evident in its plan to acquire medium companies with a strong background and solid equity, to leverage those positive characteristics and give a push to the activities of both companies. The integration allowed to strengthen the position on the market, and to enlarge boundaries.

The year after, in 2002, other two important acquisitions: Sella and Mosca, and Zedda Piras. The first one in particular is important, because allowed the Campari Group to settle its first branch in the Chinese market, the driving-force of emerging economies.

In 2003, the acquisition of Riccadonna, the Company reinforce its presence on the Australian market, and Barbero 1891 (that has Aperol in its portfolio). This move allows to exclude a relevant italian competitor, Aperol, that could potentially become stronger due to the combination with sparkling wine for the famous aperitif drink. This way, Campari group has envelop a competitor, acquiring its target customers and know how.

In 2005, Campari group acquired Terruzzi & Puthod winery (one of the biggest Tuscany-based winery that produces wines sold in 20 countries), and extended its portfolio to Latin America, East Europe and Asia.

The year after has been the turn of GlenGrant and Old Smugglerthus, from Pernod Richard, that was the first approach with the whisky market.

Cabo Wabo become part of the Campari group in 2007 (the Cabo Wabo tequila was founded by the rockstar Sammy Hagar, and is one of the more fasting growing companies in the luxury sector), the year before two important operations that were aimed at entering new emerging markets: Destiladora San Nicolas, a mexican company, and Sabia S.A, argentinian one, were acquired in order to enter new potential markets, leveraging the knowledge that those companies already have and avoiding failure of entering operations.

Besides, the acquisition is an easier way of entering those markets that are still very controlled by Governments.

2009 was the year of the biggest acquisition ever made by Campari: WildTurkey whisky become a brand under the red flag of the Group. This operation was a huge growth opportunity, because focused on a new product and a strong market, entering the Bourbon whiskey segment.

In 2010, Carolans and Frangelico were acquired, while in 2011 was completed the acquisition of Vasco CIS (Russian one) and Sagatiba (Brazil), still in line with expansion in emerging markets. The 6 July 2011 the Group celebrated the tenth listing anniversary, ten years during which the Group has tripled net sales and profitability.

In 2012, acquired the controlling stake in Lascelles de Mercado & Co. (Jamaica), that allowed the second important entering in a new market, after whisky: the rum one, with the Jamaican firm; this move generated positive returns even in a crisis moment like it was, thanks to the positive results in the USA and the reinforcement of distribution capacity. In 2013 Copack Beverage and in 2014 Forty Creek distillery Ltd and Averna SPA (that will be on focus below), become part of the Campari`s portfolio. The Copack Beverage is a leader in bottling, in the australian market, specialized in ready-to-drink packaging. The operation has been paid 20 million australian $.

The strategy followed by the Corporate management during the years is quite clear: instead of entering new markets with its own products, is seems to be more clever to acquire local brands characterized by strong equity and solid financial statements, in order to develop distribution platforms into emerging markets, strengthening owned segments and enriching the portfolio, both gaining power against distributors and suppliers, important feature in this market. Strategic alliances were developed, that later ended up in complete acquisition. This kind of corporate organization underline the strong integration capabilities that we mentioned in the first and second chapter, and are crucial and relevant to obtain the best return from the acquisition.

Besides, from the mid Nineties, the international expansion was led by a capillary distribution network through direct relation with local wholesalers and retailers, and the outsourcing process of distribution to external actors, to shrink fixed costs. This strategy facilitated the acquisition of local know-how, the direct control over the process, an increase in profit, and a good control on quality, but on the other hand it resulted to be less flexible, using a huge amount of investments (acquisition of external forces is pretty expensive), and an increase in costs of coordination. The good management capabilities allowed the company to gain the best results from this strategy, even considering the difficulties that this process could bring. Those actions were possible thanks to the business strategies that are the basis for the external development: a diversified network of raw materials, that allowed to easily cover all the needs of the markets, the capability of well balance the debt instruments, so to finance its activities through both the financial debt with baks and the stock market, and finally a huge and deep marketing campaign policy that push the products all over the world creating a strong brand awareness in customers. The choice to invest in costly acquisitions instead of reach the immediate profit is a policy choice of the Group, that has a long-term view and concentrate on long running results instead of immediate profits, to generate a more sophisticated and stable growth.

The synergies created during the years were focused on research and development of products that could best fit the tastes of customers, responding to the market needs, launching new product with the support of appealing marketing campaign. Besides, the diversification of products portfolio allows to cover a huge range of different targets, from young to adults, from spirits lovers to wine tasters. Thus, the Campari Group`s portfolio is an example of business mix that enters different sectors: balanced supply of products with different profitability, combination of emerging and mature markets and offer. The portfolio composition, the presence on huge geographical areas and the variety of leadership products are the principal points of strength of Campari Group.

Thus, it is possible to summarize the ways in which Campari Group has expanded its presence abroad, becoming a multinational company in:

- acquisition of segments in which the Group already has control over distribution;
- incorporate local brand with strong equity base to consolidate the presence abroad with different offer;
- create synergies through acquisition of new brand in distribution;
- give the license to local producers and distributors, when it is not possible for the Group to directly enter a new market.

As mentioned previously, the aim is to enrich the portfolio in order to consolidate the leadership and bargaining power in each single market.

Major financial stability and minor vulnerability on the market, expansion linked with the exploitation of economies of scale, more bargaining power against distributors, strengthening of the know-how, and use of the made in Italy effect, are just few of the objectives that the Group wants to achieve through its internationalization policy.

The Campari Group case is one of the most interesting in the Italian context, and many would be the details to be analyzed in order to better appreciate the strength of this corporation. I gave a brief overview of Campari activities during the years, and an input for discussion concerning the reasons why it chooses to adopt a certain strategy for internationalization. Here, i want to focus on the last two relevant acquisition operations that saw Campari in the front raw, to give a tangible example of how it acted, why, and which are the expected returns on investments. Thus, i am going to present briefly the two acquisitions of Averna Group and Forty Creek Distilled LTD.

4.2.1 Acquisition Of Forty Creek Distilled Ltd, The High-End Canadian Wisky Company

Forty Creek Distilled LTD is a leading independent owned spirits company in Canada, owner of a strong portfolio of brands including whiskey, vodka, brandy, rum and liqueurs. With its whisky brand Forty Creek, Forty Creek Distilled is the fastest growing player in the Canadian whisky category in Canada and well positioned in the US market to exploit the high potential offered by the Canadian whisky category. [84]

The transaction marked the first move into the growing and attractive Canadian whisky category with high-end premium products. Forty Creek Distilled operates as an integrated business that produces and sells spirits and provides contract blending and packaging services for third parties, including Campari Group's Appleton Estate rum for the Canadian market. The turnover of Forty Creek Distilled has increased by +76% in the last five years, or 11.9% CAGR: from CAD$ 19.4 million in FY 2008 to CAD$ 34.1 million in FY 2013.

It has won 3-Time Canadian Whisky of the Year champion at the Canadian Whisky Awards (2010 -12) and recently captured 5 Golden medals at the Beverage Testing Institute competition in Chicago (2014).

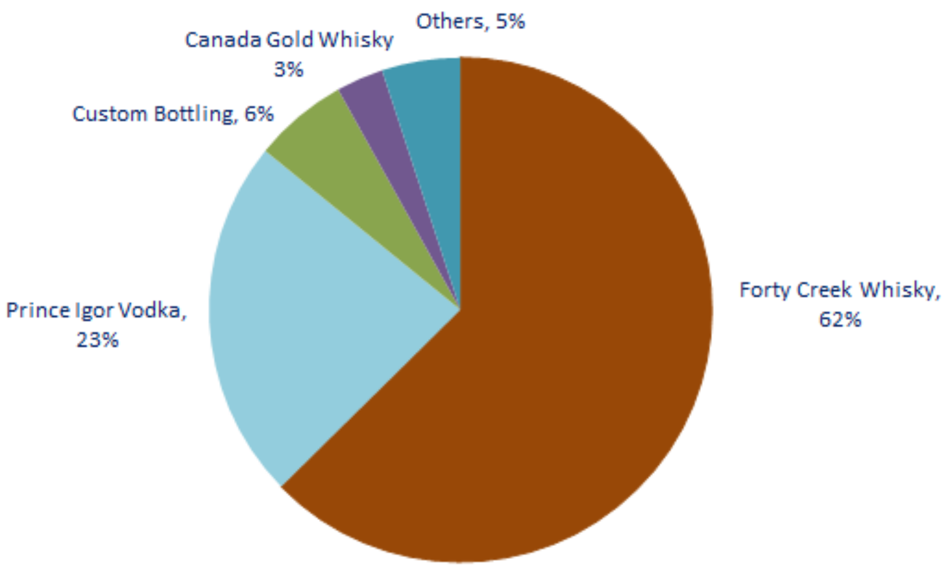
Forty Creek Distilled has a strong portfolio of brands including whisky, vodka, brandy, rum and liqueur. Whisky brand Forty Creek represents c.62% of the overall portfolio net sales in 2013 whilst vodka accounts for c.23%. From 2009 to 2013, it has grown its net sales from CAD$ 21.4 million to CAD$ 34.1 million with EBITDA margin grown from 22.9% to 28.4%.

With its flagship whisky brand Forty Creek, Forty Creek Distilled is a top supplier in Canada with an estimated market share of 7.4% in 2013 (LTM

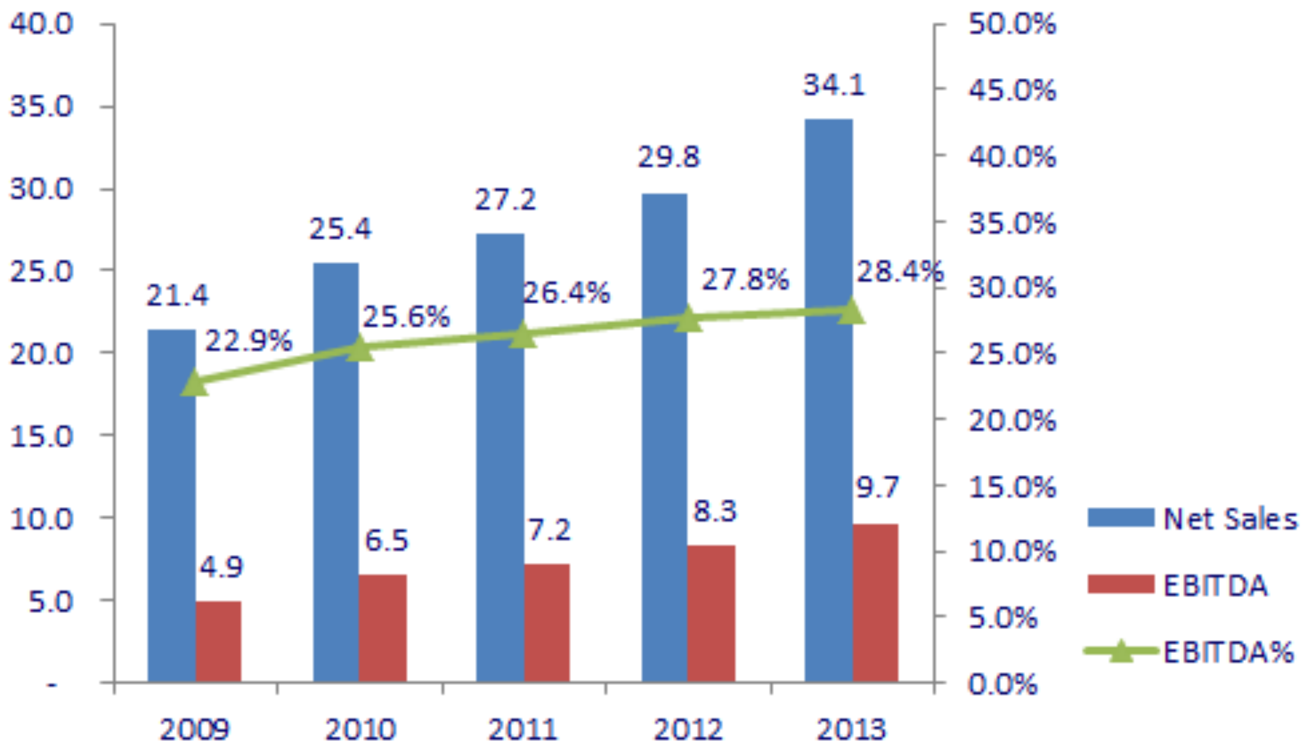
[84] Campari Group relation, "Acquisition of Forty Creek Distillery", 12 March 2014, from Campari Group website

September 2013) and the 4^{th} largest whisky supplier in Ontario, FCD’s core market, with an estimated market share of 12.5%.

Forty Creek is positioned as a high-end, handcrafted whisky brand. The product range has been successfully innovated by introducing new expressions and enhancing the brand’s versatility. As a result, Forty Creek whisky has effectively attracted consumers beginning to turn to brown spirits and looking for a richer taste. The brand family includes: Barrel Select , Copper Pot, Forty Creek Cream whisky and Reserve & Limited Editions (Deluxe Expressions).



Forty Creek Net sales Breakdown 2013



Forty Creek Financial Trends (2008-2012)

Barrel select

It is the core of the brand family, a top selling Canadian whisky and the fastest growing brand in the category (+12% in Canada, LTM Sept 2013). In its home market, Ontario, it is the 4th largest Canadian whisky brand and the fastest growing brand (10% in Ontario, LTM Sept 2013). Highly appealing liquid, strategically priced within the middle of the premium price tier. This pricing highlights and supports Barrel Select's high quality, yet affordable brand positioning Consistently received Gold Medals at the Beverage Testing Institute, Chicago, from 2010 - 2013; won Gold medals at both Beverage Testing Institute competition in Chicago 2014 and Wizards of Whisky Awards 2014.

Igor Vodka

Consists of Prince Igor Premium and Prince Igor Extreme. Prince Igor Premium is the core brand, and is positioned within the standard price range. Prince Igor Extreme was developed as an opportunity to extend brand presence into the premium price category. Prince Igor is a leading selling vodka in Canada. In Ontario (c.62% of the brand sales), it's the 4^{th} largest selling vodka.

Include a portfolio of regional brands which are sold in Ontario only. In particular, they include: Small Cask Brandy and Canada Gold Whisky.

The global market for the Canadian whisky now represents c.17.5 million cases annually. Whisky has a 27% share of the spirit business in Canada. The premium and deluxe price tiers represent c.72% of the spirit sales in Canada. Ontario is the largest spirit market, commanding almost 40% of all spirits sold in Canada.

Worldwide, the overall market size for Canadian whisky in 2012 was c.20 million cases (c.6% of total whisky category). Geographically, the US is by far the biggest market for Canadian whisky. It represents c.75% of the overall Canadian whisky volume in 2012. The second biggest market for the Canadian whisky category is Canada accounting for c.17%.

Focusing on the US market, whisky is the second largest selling spirit behind vodka with 52 million 9L cases in 2013. Within the whisky category, the Canadian whisky has 31% of the volume share, slightly behind Bourbon. Overall, Canadian whisky commands c. 8% share of the US spirit market.

US is the largest market worldwide for Canadian whisky with c. 16.5 million 9L cases in 2013.[85] In the recent years, a whisky revival has occurred in the US: consumers increasingly interested in brown spirits and looking for a richer taste experience. The whisky category growth is driven by the increasing

[85] Source: Discus 2013

attractiveness of premium and high-end priced whiskies, as well as strong and growing consumer interest in handcrafted expressions.

The US opportunity for Forty Creek whisky. In the past year, Canadian whisky had a volume growth of +2.9% and value growth of +6.1%, with solid contribution from pricing. The high-end spirit price segment in the US experienced tremendous growth from 2012 to 2013. For Canadian whisky specifically, the high-end premium and super premium segments had value growth of +62.8% and +9.1% respectively in 2013 vs. 2012 . In most US markets, Forty Creek whisky is positioned as super premium, priced at c.50% premium compared with the market average. Today the US market accounts for c.20% of Forty Creek whisky sales. The US market, the largest for Canadian whisky and fast growing in the premium and super premium category as well is showing strong interest in handcrafted whiskies, is a solid growth opportunity. Forty Creek whisky portfolio is perfectly positioned to meet the demands of this consumer group as a high-end, handcrafted whisky brand

4.2.1.1 Strategic Rationale Behind The Acquisition

The Campari Group has a series of reasons that pushed toward the acquisition of the Distilled:

- Enter the large and growing Canadian whiskey segment with a leading, profitable and fast growing brand in North America;
- Further premiumise Campari's brand portfolio, driving richer product mix, effectively positioning itself to capitalize on the revival of brown spirits, particularly in the US;
- Exploit Campari's existing route-to-market in the US to efficiently achieve revenue synergies and growth acceleration and strengthen route-to-market in Canada by combining the two portfolios;
- Internalise bottling activities in the Canadian market.

Forty Creek Distilled is an attractive and complementary addition to Campari's existing premium and ultra-premium spirits offering, enabling the Group to further build its critical mass in key North American markets. The acquisition represents an ideal fit with Campari's acquisition criteria in terms of type of brands (hidden gems, fast growing and profitable brands) as well as provides a long term opportunity to enhance Campari's premium portfolio and add critical mass in key North American markets.

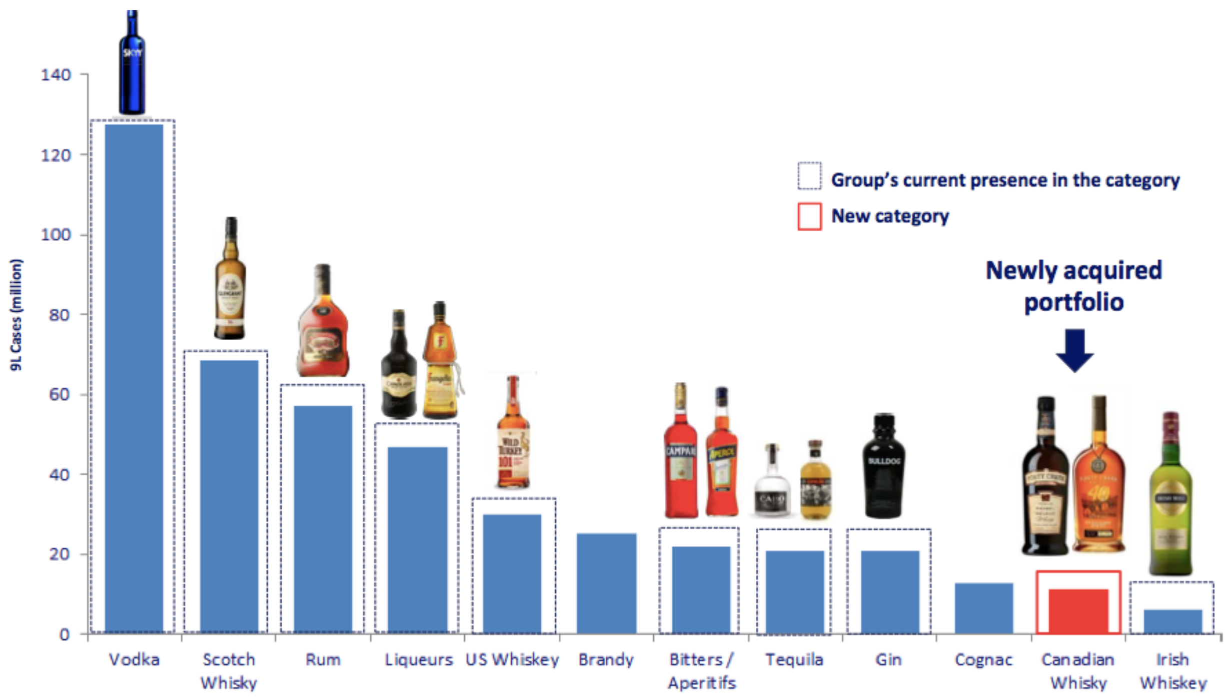


Figure from CampariGroup data: Global premium brands categories by volume, 2012

Looking into the future, thanks to the acquired whisky portfolio of FCD, Gruppo Campari is well positioned to:

Short term:

- Develop the acquired portfolio in its core markets (Canada and US), successfully exploiting the brands' high-end and handcrafted attributes within the growing and premiumising Canadian whisky category;

- Continue to efficiently leverage Campari's strong route-to-market in the US;
- Internalise bottling activities in the Canadian market

Long term:

- Further premiumise Campari's brand portfolio, driving richer product mix, effectively exploiting the revival of brown spirits, particularly in the US;
- Grow the acquired portfolio beyond its core markets by leveraging the international appeal of the Canadian whisky category, coupled with Gruppo Campari's strengthened distribution capabilities.

4.2.2 Acquisition Of Averna Group, An Italian Leading Actor In The Spirits Market

The independent business owned by Fratelli Averna is based in Caltanissetta, Sicily, and has an history of more than 150 years. Owning a portfolio characterized by high and premium margin brands, Averna Group is a leading company in the italian spirits market, covering a leadership position in key segments such as bitters, grappa, and limoncello. Its most famous brad, Averna, is the second largest brand in the italian context of bitter liqueurs with a market share of 15%, and is a key player for the German market as well. Other relevant brands in portfolio are: Braulio (the second best selling bitter liqueur in Northern Italy), Grappa Frattina (leader in the grappa segment), and Limoncetta di Sorrento (the third best selling lemon liqueur in Italy). [86]

Over the italian boundaries, the group generates almost 35% of its net sales, in particular in Germany and Austria, markets that together account almost

[86] Campari Group Relation, "Acquisition of Averna Group", 15 Apri 2014, Campari Group website

60% of Averna Group international sales.Other interesting financial results that are relevant in the valuation of the transaction of acquisition, and are leading in the choice of Averna group as target company are as follow. In 2013, net sales were of euro 61.8 million, registering an increase of 3,1% compared with 2012. The EBITDA in the same year was 9.2 times (EBITDA gives a proxy information about how much profit the company makes with its present assets and its operations on the products it produces and sells, as well as providing a proxy for cash flow), thus registering positive forecasts for the future.

BRANDS PROFILE: Averna

Some numbers to describe the Averna brand:

- annual sales of almost 4 million liters;
- second largest brand in the italian market;
- accounted for 40% of the sales of the acquired business;
- well known brand, awareness around 95% in Italy;
- natural ingredients prepared following a secret recipe unchanged for 150 years;
- perfectly balanced bitter-sweet taste, with alcohol content of 29%;
- 39% of the brand revenues is achieved internationally;
- present in more than 65 countries, with core markets in Germany, Austria, Switzerland, that account for 80% of the international sales.

Its value is embodied in the unique and complex taste, that is characterized by the uniqueness of its natural ingredients. It is a full part of italian culture, with its heart in Sicily, with the tradition and authentic bitter premium positioning.

BRAND PROFILE: Braulio, Limoncetta and Frattina

Braulio brand is the number 1 bitter brand in the Italian Alps, with annual sales of about 650 thousand liters, and 2,8% market share in volume terms in the italian bitter segment.

It was created in 1875 in Bormio, and still has its characteristic features that have led it to be the most appreciated bitter in the Alps territory. Through the launch of limited editions of special reserve, it increased its visibility and revenue, ending in accounting 7% of the sales of the acquired company.

Limoncetta di Sorrento, instead, is a South Italy typical drink, completely natural liqueur, strictly following the traditional Sorrento recipe (it is a IGP product, protected geographic indication). In the on-trade channel, it accounts for 4,3% of market share, and 3% in the off-trade channel; it accounts 4% of sales of the acquired business.

Lastly, Fratina is leader in the single-vine grappa segment in Italy, covering the 25% of the total grappa category, with a market share of 13.3% in the on-trade and 6% in the off-trade channel. It is a pure single-vine grappa, to guarantee high level of quality continuity and a standard taste consistency.

4.2.2.1 Strategic Rationale Behind the Acquisition

Concerning the strategy underneath the acquisition, Campari group wanted to leverage its existing foreign route-to-market to accelerate an international profitable growth, particularly in the Americas, and Averna and Braulio were in line with this strategy. Besides, the two leading brands were a good option for Campari to strengthen its position into the bitter category, thanks to:

— leading position in the italian spirits market and high potential for international expansion;

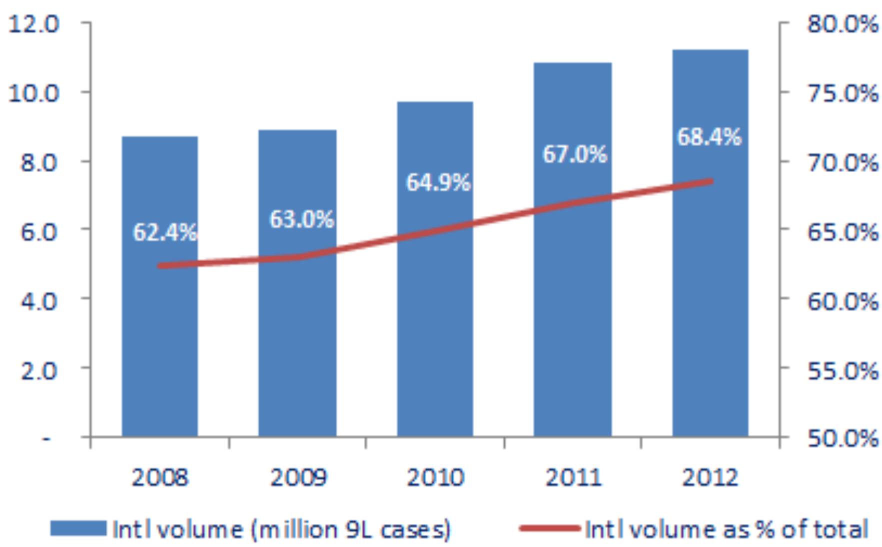
— strong brand image and premium positioning;

— high margins and strong cash generation capability.

The strong position of Averna group`s brands in the Central Europe, in particularly Germany, was a positive feature for campari, that wanted to increase the critical mass in those territories beyond home market. The growth potential in the US was another point considered important to be exploit, considering the growing interest of mixologists and local consumers are showing a growing interest in bitter and liqueur, in particular the italian ones.
Campari wanted to enter the grappa market as well, and the liqueur category.
Considering those aspects, the common interests and the potentialities of the brand, Averna Group resulted in being valuable and complementary to Campari, balancing and enriching each other premium spirits offer. Averna Group acquisition offers Campari Group strong potential to achieve profitable international growth, further premium its portfolio, driving richer product mix and capitalize on the revival of italian specialities, particularly in the US.
Values and mission were common in the tho groups, and also strategical desires of expansion, To combine the strength of those groups is one of the most positive example of well defined and well managed acquisition, in which the choice of target firm is not random but structured and based on solid basis.
Looking into the future, through Averna Group acquisition, Campari can achieve different goals: on one hand, Averna Group is well positioned to further premiumise Campari’s brand portfolio, driving richer sales mix and develop the acquired portfolio beyond its core markets by leveraging the international appeal of the Italian specialities with the Group’s strengthened distribution capabilities. In the Italian market, bitters represent, together with grappa, the third largest category (11% each) after aperitifs (26.3%) and liqueurs (11.8%), followed by lemon liqueurs (7.1%). Within the bitter category, Averna is the second largest brand with a market share of 15%, whilst Braulio has 2.8% market share. Within the lemon liqueurs category, Limoncetta Di

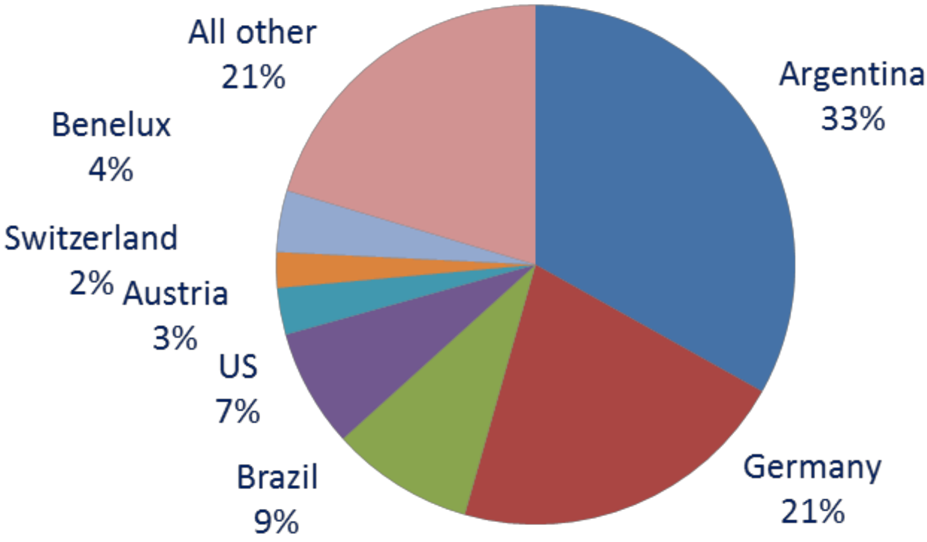
Sorrento has 3.4% market share, and Frattina has 2.4% market share within the grappa category.

On the other hand, the acquisition further strengthen the leadership position of the core brands and achieve growth by brand building mainly in the European markets, and, in the core US market, with Averna, further enriching Campari Group existing offer of Italian specialities, including Campari, Frangelico, Cynar and Aperol. Besides, Italian bitters / liqueurs are gaining more popularity globally: overall, 70% of the Italian bitters / liqueurs are sold outside of Italy, with Argentina, Germany, Brazil, USA and Austria as the top 5 export destinations for the Italian bitters / liqueurs category.[87] From 2008 to 2012, the Italian bitters / liqueurs consumption outside of Italy grew overall by 29% (CAGR: +6.6%), here splitting the numbers for Germany (being the second largest international market for Italian bitters / liqueurs, grew volume overall by 14% (CAGR +3.4%)), and Argentina (more than doubled (CAGR +22.4%)).



Italian bitter bitter / liqueur volume trends outsideItaly, 2008-2012 (CAGR +6%, left column)

[87] Source: IWSR 2012



Volume by geography, outside Italy, in 2012.

CONCLUSIONS

Nowadays, the process of internationalization is necessary to all that companies that want to continue competing on the market in a medium large scale.

The changes in the economical, political, social environment makes it necessary to face the new challenges looking for new responses and pushing toward innovation not only of products but also internal organization and firm structure (thus, to go abroad to answer specific needs of the market, requires a de-structuration of company`s organization in order to include the new foreign perspective). The challenging dimension is this one, more than the mere internationalization process: the persons that work inside the company need to be trained and the internal processes as well have to be improved and constantly being integrated into the new bigger and much complex structure of an international entity, in order to obtain the expected returns on the investments.

As mentioned along the dissertation, the human side of the company is the one that makes the difference between a working and a failing process: the human capital is the key resource, and has to be put in the condition of well acting both in the single-market and multinational one, toward a continuous process of integration, training, and cooperation.

Differences linked with culture and social distinctive features made it necessary to include integration policy all along the process of internationalization, to keep under control the impact that those differences could have on employees and key figures. This observation is true especially in the cases of opening up new branches, including new firms into the frame of the company (t.i., acquisitions and mergers between firms), situations in which conflicts can arise, due to differences in human behaviors and perspectives (rather than mere export process in which the internal structure of the company remains quite the same).

In particular, when two companies decide to merger or one decides to acquire another one to expand their business (let`s say, when companies get involved in a relation that is closer than the mere commercial exchange of products or services), many aspects have to be considered, that are as important as the financial one, but could be more difficult to manage. The combination of already existent knowledge, the acquired one, the integration of managerial competences and leadership capacity, are competitive attributes that have to be carefully taken into account during the merging or acquiring process, precisely for its crucial role into the firm.

This capability of including acquiring and acquired companies human capital and integrate them in a cycle that brings positive returns can be found in many examples mentioned along the dissertation: the case of LVMH acquisition of Loro Piana underline the importance of consolidate the high value added know-how of italian cashmere manufacturers and the highly structured and internationalized luxury multinational. Here, both companies are characterized by entrepreneurial management style and the core business focused on excellence products and manufacturing. The strategy of LVMH is to create a point of convergence of excellences, while allowing each company to maintain their independence in management, subscribing the mission and value code of the Group. This feature is basically focused on acquiring potential and fast growing companies, leaving them the chance to continue their activity quite freely, without changing the internal processes, just framing them into the overall group philosophy. By adopting this approach, both companies gain in terms of efficiency and returns on investments: Loro Piana can enlarge its boundaries of influence through the exploitation of LVMH distribution channel, financial resources, and deep experience in the luxury sector, while LVMH acquires a top-manufacturing company that enrich its brand portfolio and brings to the group a deep knowledge in a niche sector that can reinforce its presence in smaller yet highly profitable markets. The continuity of management, from the Loro Piana point of view, is achieved: Antoin Arnauld (the son of Bernard) has been nominated executive president of the company, while the Lor Piana brothers have been nominated vice-presidents by the Board of Directors, underlining the importance gave to the brand and its continuity with the past management. «*It is an honor to rein Loro Piana together with Sergio and Pier Luigi, that have made the Maison a model of excellence and a benchmark for those people looking for exceptional products - says Antoin Arnauld- We will work hand-in-hand to reinforce and expand the huge potential of this maison*».[88] It is a win-win contract, that is expected to leverage the know-how and push profits.

Other extremely positive examples of perfect integration between companies are the ones concerning Campari Group, analyzed in the last chapter, that again underline the importance of integration processes between companies that act in the same field, but in different segments, allowing them to obtain positive returns and growth perspective.

All the cases mentioned along the discussion have few features in common: the flexibility and independence gave to the acquired company, to integrate its business in the acquiring one, but having the chance to maintain its individuality, without wasting its core competences and key resources, yet investing in expansion and internationalization leveraging on those critical characteristics to enforce the business development. Integration is achieved through a patience and extremely controlled process that avoid as much as possible, shocks and conflicts, to preserve the integrity of the value saw by the acquiring company in the target one. Here, it is possible to clearly appreciate the importance of human capital, that makes the difference between medium and excellence business, and its capability to develop a growing perspective that made each company unique.

[88] Interview La Stampa-Biella

It is possible to say that competences, know-how, leadership and adaptation capabilities, are the core features for those companies that want to win the match against international growth, as the few cases exposed reflect. Many companies are not able to reach the result they wanted to, because they are not able to focus in the right way on crucial mechanisms that then lead them to the failure of the process, or the incomplete achievement of their aims.

This incapacity is sometimes linked with an excessive focus on non-core aspects, such as the mere financial one, that alone is not sufficient to justify the difficult and challenging process of merger or acquisition. Paying attention only on financial resources and achievement of financial return in the short-medium term is not enough to obtain a positive trade off at the end of the agreement, yet it could end up in nothing, just a wasting of time and money. The right target company has to be chosen not only for its financial stability, equity solidity and cash flow, but also from the perspective of similar strategy, mission and values that have to be shared between companies, because this both avoid mismatching of intents, and divergences in management methods.

Talking about internationalization methods, we can not focus only on merger and acquisition, because this method is quite complex and requires a huge amount of commitment, that can be afforded mainly by medium and large enterprises.

The small and medium ones, that want to actively enlarge their boundaries and enter new markets (thus, they are not target companies like in M&A, but want to act as single leader of the process of going abroad) can chose between different choices, considering their resources to be committed, results achievable and desired goals. If a company is willing to enlarge its distribution channel, it could be enough to export its product or service through the exploitation of already existent links with the entry market (t.i., partnership, rather than direct export), or to directly enter the market exporting. This option is less risky than merger, and its aim is undoubtedly less strong as well: indeed, the choice to export the product does not necessarily requires to change the internal processes as deeply as in the merger or acquisition case, thus the impact on activity is lighter and less expensive, even if it requires the reorganization of some internal processes that has to be defined in order to support the export flow.

Foreign direct investments are a choice in between the export and M&A, even if the concept of M&A is absorbed by the broader concept of FDi, that in itself is the direct investment that a company makes in a foreign market, in terms of ownership of foreign activity, control over the market and commitment.

When a company has tested the market through export, it can decide to go deeper in the exploration of new countries passing to analysis that creates a more detailed overview of economy perspective to understand the profitability of the investment: this is the shift from export to foreign direct investment, that starts with a more structured plan of action and end up in a deeper relation between the company and the foreign market.

Trying to sum up what I talked about along the entire dissertation, the starting point is for the company to understand where it wants to go, which result it wants to obtain, to give a consequent direction to the internationalization strategy. The first step to be done by each company is to study the potential market and to understand which are the critic points of entering it, while considering the results achievable as well. In this section, the company has to make a consistent investment on cumulate useful information that help it understand whether a country is profitable or not. Then it has to make internal changes, that can be more huge when the enter in the new market is more pervasive (i.e., merger or acquisition of local company), or consist in adjustments of the current organization, if the process is less pervasive (i.e., export channel). Each decision has consequences, and changes are obliged to allow the ongoing process. Sometimes the company may be required to loose its control power, for example in the case of partnership and joint-venture, but the final result will (probably) pay the initial investment. This step may include the opening of foreign branches to give more support into the new market, or the settlement of more exclusive partnership with local actors to intensify the action on the territory. Lastly, when the companies have found a perfect integration and communality of intents, they can consider to merger, or one to acquire the other (this could be also an aggressive takeover, in which the target company has no choice but be sold at the acquiring one).

In a world that is continuously becoming wider, markets become more open as well and customers become more aggressive in looking for specific products and services. To create a network, strategic alliances, partnerships or new entities, are different ways to respond to those pushes. The firm that wants to expand its coverage in foreign market has the chance to chose into a variety of different chances, that respond to different goals and needs. Not always the result of the project will be positive, sometimes could also represent the end of the firm, the failure of its activity. But for the more structured, patience and wise, the positive result is quite sure.

Every company has to have clear in mind where it wants to end, and what it wants to achieve in terms of firm`s growth and financial results. Never forgetting the importance of human capital, the company has to structure a flexible yet profitable strategy of internationalization without undervalue potential difficulties and differences. To start from a proxy country is a way to enter new markets, more similar to the home one, and gain reliability, experience.

Try, to understand the real potential of the company, and risk, to understand the force of the activity. Without entrepreneurial mentality, it is difficult to succeed. Without competences, know how and resources, even impossible. Italian companies have all those features, they have to learn how to exploit them, following the example of the many companies that did it, and now excel.

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