Preface

In the last decades, the volume of merger and acquisition activity has increased across the world, affecting virtually all industries, regardless of size and type of firm involved. Mergers and acquisitions occur in waves and represent a way to grow quickly, seizing the opportunities arising in certain industries. It also represents a way to easily overcome the barriers to entry, to profit from fiscal advantages, and to achieve a positive effect on the firm's image.

Through mergers and acquisitions, firms can seize the opportunities to grow and create new economic value, but, as a wide empirical evidence proves, they can also destroy value for shareholders.

This highlights that the decision to carry out an M&A is certainly a risky decision, because of the number of variables influencing the final performance, but it is also a decision frequently based on wrong objectives and an incorrect evaluation process. This firm belief led us to study in depth how this decision should be taken to increase shareholder value. For this to happen it is necessary that the value of the combined firms is greater than the sum of the values of the bidding and target firms, operating independently. But, for this to happen, it is also necessary for the estimated synergies to be well predicted, evaluated and carried out, appropriately managing the integration of companies.

With this as our starting point, the study aims at offering solutions for reducing the currently high percentage of M&A failures. To contribute to this result it is believed that the following is necessary:

- to acknowledge the creation of value for shareholders of the acquiring firm as the fundamental objective of an M&A;
- to define analytical models suitable for properly evaluating M&A;
- to design appropriate organizational structure and processes to implement M&As.

The approach of the book is normative; it uses a theoretical analysis to show what managers should do to increase shareholder value through M&A strategies and what the conditions are for favouring one or the other type of M&A. The perspective of the analysis is that of a company which considers the opportunity of acquiring another company for integrating its activities in a merger.

It is important also to specify that very often M&As are also motivated by the *value of control*, that is the value that occurs post deal when the target firm is managed more effectively by the new management. In this case an acquirer believes that incremental value can be created by running a target firm more efficiently.

In our analysis, we do not consider these types of M&As, but only M&As carried out to exploit the value of synergies, that is the value realized by combining the two different entities in an M&A deal. Even if it is difficult to separate the two values, it is necessary to clarify that synergies are obtained by combining the two different entities in an M&A deal, while the *value of control* does not require an analysis of the acquiring firm, because the value of control resides entirely in the target firm.

The order of presentation of the topics reflects the actual growth of many firms: expansion starts within a core industry and it is undertaken to enhance or protect a firm's position in that business (*horizontal expansion*). Then, a firm moves outside its initial industry integrating its activities or phases along its value chain (*vertical integration expansion*) until over the years it becomes increasingly more and more diversified, entering different related industries and finally unrelated industries (*product diversification expansion*).

Each M&A is viewed as an investment decision directed at creating value for shareholders, exploiting the various opportunities offered by the internal firm resources and the environment. Each M&A strategy implies different changes in the firm's system and causes different effects on the firm's long-term cash flows. Therefore, defining a growth strategy which creates value requires examining the internal conditions of the acquiring and the target firms, evaluating the dynamics of the external environment in which the firms operate and estimating the expected effects on the value of the combined company.

To evaluate whether or not an M&A strategy can create value, we present some analytical models capable of specifying the relevant conditions under which each type of strategy can create value and be suitable for practical use.

However, we know that, in order for a defined strategy to create value, it is also necessary to adapt the firm's organizational structure so as to effectively manage the increased complexity of the new business system. To reach this aim the organizational structures which can offer the best solution with respect to each growth strategy are analysed.

The book highlights the fact that growth through M&A does not necessarily produce an increase in the enterprise and in the shareholder value; that clearly results only under particular conditions. Thus, top managers must carefully evaluate every growth alternative.

The book contains 13 formal chapters.

Chapter 1 introduces a fundamental terminology and some basic concepts concerning M&A strategies, pointing out the principal patterns of firm development.

Chapter 2 examines the empirical evidence on M&A performance, according to a large and authoritative literature. The results of empirical studies indicate that a high percentage of M&As fail in terms of profits and value created for shareholders.

Chapter 3 provides the essential theory concerning the firm value and the evaluation of an M&A strategy.

Chapter 4 illustrates how to analyse in depth the structure of firms involved in an M&A, for discovering which activities and resources offer the best opportunities for producing synergies. Then, it illustrates how to analyse the industry structure and dynamics, to properly understand opportunities and risks in an M&A.

Chapter 5 examines the characteristics of horizontal M&As and the conditions under which they can create value. In particular, it examines the economic conditions from which synergies derive and proposes an analytical model that defines when an M&A can create value for the shareholders of the acquiring firm.

Chapter 6 addresses the economic rationale for vertical M&A strategies.

Chapter 7 shifts the focus onto product diversified M&As, examining the conditions for which they can create value.

Chapter 8 examines the alternatives for financing M&As and the effect on the merger value.

Chapter 9 examines the appropriate organizational models for managing M&A integration.

Chapter 10 presents a summary of results and the conclusions of the first part of the study.

In these chapters the theoretical exposition is often followed by numerical examples and simulations.

In Part II of the book some cases of successful M&As are presented. The purpose of these cases is to highlight how a firm chooses and implements a defined M&A strategy creating value. Chapters 11, 12 and 13 analyse three cases of successful M&A strategies: L'Oreal, Campari and Luxottica. These companies are all characterized by a long period of continuous growth mainly based on M&A strategies, accompanied by a systematic creation of value for shareholders. Each company is characterized by specific M&A strategies and reveals its own original pattern. At the same time, all three companies present a common behavioural pattern: each of them makes leverage on its specific resources and exploits its strategic assets to cope with industry dynamics and environmental changes. The direct analysis of these cases confirms that an M&A can be a fundamental instrument for growth,

increasing competitive advantage and creating value for shareholders. Thus, the cases provide a link between theory and practice, making, we hope, the analysis more real and interesting.

The book is based on established traditions in strategic management research. In particular, a number of insights are drawn from three distinct bodies of research: the resource-based view of the firm; organizational economics – in particular transaction costs analysis – and the fundamentals of corporate finance. All these theoretical traditions made a substantial contribution to the arguments advanced here.

In particular, we believe that M&A strategies have to be based both on the existing firm's system characteristics, that is the firm's assets, resources and capabilities, and on the dynamics of industry structure. Heterogeneity of resources and firm-specific characteristics form the basis of diversity and the strategic variety of firms.

The book is mainly directed at researchers and students in economics and management. As it offers useful tools for managerial decisions, we think it is also of interest to managers and consultants.

This book is the result of some years of research developed at the School of Economics and Management at the University of Siena and at the LUISS University of Rome. Outside school I have learned a lot from my experience as a management consultant and as a member of the board of directors of some industrial companies and banks.

Prof. Angelo Dringoli

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To Simonetta and Tommaso