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BUSINESS AND LEGAL ASPECTS OF CROSS-BORDER M&A UNDER SCRUTINY OF THE MERGER REGULATION 4064/89/EEC

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1. INTRODUCTION

The European Union (EU) is heading for an increased economic, legal and political integration of its Member States.[1] In spite of all the efforts to bring the people of Europe closer, significant differences in national laws and cultures still exist. Enhanced understanding of such disparities can create opportunities for companies operating on the EU market in several areas, including the way to deal with mergers and acquisitions (M&A).[2] In this thesis mergers will be considered as a full joining of two previously separate corporations into a newly created third entity, whereas acquisitions will be defined as assuming ownership of another business, either through a friendly acquisition or a hostile takeover.[3] It is often disputed whether all M&A should be allowed according to the free market principles or if a certain institutional body should have the competence to control them for the purpose of preserving the competition and protecting the consumers. The EU's choice for the latter originates from the EC Treaty, where it is clearly worded that its main goal is not only free market development, but also increased employment, social protection, environmental standards etc.[4] Even though the EU legislation on M&A applies to all the Member States equally, various areas remain uncovered. This thesis will point out some difficulties the companies have experienced in dealing with M&A within the Community and it will seek to raise awareness of available options to improve future actions. As regards the legal considerations, M&A will be analysed mainly from the competition law angle, whereas

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[1] The European Union currently comprises 25 Member States. Until 1st May 2004 it consisted of 15 Member States, which will be referred to as the *old Member States*. On 1st May 2004 ten more countries joined the EU, and they will be referred to as the *new Member States*. The old Member States are: Austria, Belgium, Denmark, Germany, Greece, Finland, France, Ireland, Italy, Luxemburg, Portugal, Spain, Sweden, The Netherlands and United Kingdom. The new Member States are: Czech Republic, Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia.

[2] The most relevant definition of M&A is given in the Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings, Article 3(1): "A concentration shall be deemed to arise where: (a) two or more previously independent undertakings merge, or (b) - one or more persons already controlling at least one undertaking, or - one or more undertakings - acquire, whether by purchase of securities or assets, by contract or by any other means, direct or indirect control of the whole or parts of one or more other undertakings."

[3] The thesis will follow the definition given by Kautz, J. She defines *merger* as a "full joining together of two previously separate corporations. A true merger in the legal sense occurs when both businesses dissolve and fold their assets and liabilities into a newly created third entity, which entails the creation of a new corporation. *Acquisition* stands for assuming ownership of another business. The acquisition can be made through a direct purchase or through a merger agreement that involves the exchange of assets"; Kautz J., editor (2004) Small Business Notes, Internet database

[4] Consolidated version of the Treaty Establishing the European Community (TEC), as amended by the Treaty of Nice, Article 2 EC.

business administration considerations will be approached in the light of human resources management.

1.1. Purpose and Method

The main purpose of this paper is to determine how companies can explore the ambiguities in the EU merger control legislation and to analyse what effect it has on various market participants in the light of cross-border M&A. M&A gained rather bad reputation in the recent years, resulting in a drastic decrease of such practices. Possible reasons of M&A failures are scrutinized in order to define solid grounds on which M&A might regain their popularity. The subject is approached from a legal and a business perspective, but the macroeconomic environment and political forces are occasionally addressed. The thesis will analyse the impact of the existing competition rules on M&A within the EU and underline possible solutions to controversial issues based on these findings. Due to the extensiveness of the subject, a number of delimitations are identified later in this chapter.

The method used to elaborate on the topic is the qualitative research. A number of books and research papers were looked into in order to gain an overview of the M&A theories and practices on the EU market. They also served as a basis for identifying the underlying problems that the European companies might have faced and for determining the aspects that can be improved. Articles were mainly used for acquiring the updated information on M&A trends and public opinion flows. Finally, the EU Merger Regulation 4064/89/EEC and the corresponding competition case law are included in the study to provide an understanding of how well the legal framework applies to real life.[5] The Merger Regulation is considered to be the main guideline for M&A cases ever since it became applicable in 1990. Therefore, this thesis will focus on the events that occurred in the last 14 years. However, at times it will be necessary to consider historical developments in order to provide the full understanding of the matter.

[5] The Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings (as amended by the Council Regulation (EC) No 1310/97 of June 1997) will be referred to as *the Merger Regulation*. It was replaced by the Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings, applicable from 1 May 2004, which will be referred to as the *new Merger Regulation*.

1.2. Research Problem

Legal perspective.

Cross-border mergers and acquisitions were among the most frequently exercised practices on the global markets during the last few decades. When two or more companies engage in such transactions, they become capable of changing the entire market dynamics. This raises several legal issues in the field of competition law, company law, tax law and other areas. However, the EU competition implications are considered to be the most relevant for the purpose of this paper because they can demonstrate the interaction between companies and markets from the broadest perspective. Moreover, various legal areas can provide companies with more or less beneficial solutions, but only the competition rules have the power to completely halt a concentration if its requirements are not fully satisfied.

There are numerous legal issues that are still fairly unclear in the European Union because it can be complex to determine whether the EU supranational bodies are competent to rule a matter or if it is up to Member States to regulate. The Merger Regulation solved most of the controversial issues as regards M&A competition playfield, but there are still ongoing debates that are emphasising the necessity of increased legal transparency. The Regulation itself provides manoeuvring space to circumvent some of its provisions, which often leads to ambiguities in determining the legitimacy of such actions. Also, companies are faced with dilemmas on how to structure a deal to increase the chance in getting a clearance from the Commission. Moreover, troubles can arise due to legal and cultural diversities between the Member States. The Single European Market relies on well-defined legal system with clear distribution of roles; however, national interests still appear to be strong, making the division of powers more complex. Further problems can arise in conduct between the EU and the third countries, due to the differences in legal systems. In particular, during the last few years fierce discussions and criticism were raised as regards the EU legislation on M&A between the non-EU companies. Hence, it will be examined how this can affect the competition efficiency in general and what can be done to prevent further gap growth.

Business administration perspective.

From the business perspective, M&A can cause problems in variety of areas: production, sales, finance, accounting, strategic planning, marketing etc. Their importance for the optimal operational cycle is not contested, but the human resource implications are given the central position in the thesis. Stakeholders' interests are considered to be the most significant aspect because it is the human capital that carries out the whole M&A process. Large-scale M&A are capable of influencing lives of millions of people worldwide and their satisfaction is what gives added value to such transactions. Some M&A deals are worth billions of Euros and therefore it is vital to examine the underlying issues capable of influencing the entire outcome. This paper will address some of the most debated concerns, first through a general M&A framework, followed by more detailed legal and organizational considerations.

M&A between larger companies can affect millions of people. From the business administration aspect, these individuals will be grouped according to their interests, e.g. as employees, shareholders, etc. Thereafter, the possible impact of M&A on each group will be investigated. Cross-border M&A are expected to face more problems than domestic ones due to cultural differences, patriotism and other factors. The assumption is that companies can learn how to overcome the dissimilarities and possibly even build up wider networks of customers, suppliers and distributors. The thesis will seek to determine to what degree it is possible to employ procedural standardisation in the international environment as opposed to national adaptation.

1.3. Delimitations

The M&A literature is extensive, covering various aspects of the topic. Cross-border M&A in the EU are slightly less investigated, but it is still possible to find numerous books and research papers on the topic. Therefore, it is not possible to refer to all aspects of M&A. Instead, certain organizational issues will be discussed more in depth to highlight a number of practical problems that companies could face once they engage in M&A.

As indicated in the title, this paper will focus primarily on the M&A between the companies operating on the EU market. Despite the fact that M&A are mostly practised on the US market, this will not be discussed in detail. Nevertheless, few cases involving US companies will be touched upon in order to stress the significance of existent differences between the two legal, as well as organizational systems. Moreover, additional competition procedures characteristic for each Member State will not be examined; instead the EU will normally be treated as one unit. Even so, the paper will underline some conflicts that can arise due to diverse market cultures, legal backgrounds, political systems etc.

Joint ventures can be partial alternatives to M&A, however with drastically altered character. A short comparison will be drawn between the two options where potential benefits and drawbacks will be investigated. Other aspects of joint ventures are not within the purpose of this paper. Furthermore, only M&A between two previously independent companies will be covered, disregarding internal restructurings and relationships between parent companies and subsidiaries.

Thirdly, as regards the M&A legislation, only the Merger Regulation 4064/89/EEC will be examined in detail. It provides the most valuable guidelines and since the Regulation, by its nature, is directly binding in all the Member States, it is considered to be the most relevant in examining cross-border M&A. The new Merger Regulation 139/2004/EC was adopted in January 2004, but here it will not be discussed in depth. This is due to the fact that it became applicable in May 2004, making it too early to analyse its effects. Also, it should be remembered that there is a number of M&A that are not concentrations in the meaning of the Regulation and that do not have the Community dimension. Although their aggregate value is certainly significant, such operations will not be discussed in the paper. The deals between substantially large companies can provide a better basis to explain some of the problems that can arise in cross-border concentrations. Due to their size, it is assumed that additional problematic issues will arise, both from the legal and organizational perspective. Therefore, only M&A within the scope of the Regulation will be considered here for the purpose of clarifying the subject.

Finally, M&A have an influence on various interest groups: employees, shareholders, customers, suppliers, distributors and competitors. There are usually other parties involved, such as national governments or unions, but their role in the process is considered to be peripheral for this paper. Alternatives rather than suggestions on organising the procedural matters of M&A will be considered. Various sources offer such advice, but it is rather clear that there is no universal solution; instead, different circumstances require different strategies.

1.4. Outline

The paper is divided into three major parts: the general framework of M&A, legal implications of M&A and business implications of M&A. Before embarking on these issues, this chapter provided the reader with introductory ideas and it discussed some procedural and methodological aspects of the essay. It assessed the main problems connected with the subject and it defined the purpose of the entire thesis.

Chapter two investigates the reasons and motives for companies to get involved in M&A. Various examples are given to illustrate the unique effects generated by such practices. Before proceeding with the discussion about M&A significance, other options are examined and compared. Some of the alternatives, such as internal growth and joint ventures, are addressed shortly.

In 1990, the European Commission began to implement the Merger Regulation, which significantly increased transparency on the EU market. It introduced several innovative principles, such as one-stop-shop, to create some order in the competition procedures.[6] Soon it became recognized as a revolutionary document, well appreciated among the majority of the EU companies that fall within its scope. Legal implications, along with

[6] Hagen, M., Kubicek, H. (2000), One-Stop-Government in Europe: Results of 11 national surveys: "Under the *one-stop paradigm*, all of the customer's business can be completed in a single contact. One-stop customers do not have to hunt around, call back, or repeatedly explain their situation. One-stop customer service is convenient, accessible, and personalized. True one-stop service integrates many services that are necessary to satisfy concerns of specific client groups in specific events. These services can be integrated within one or multiple jurisdictions. Another meaning of one-stop service includes the dedication of a single contact person to handle all of a customer's concerns." When the one-stop-shop principle is discussed in the context of cross-border M&A, it indicates that the Commission has the exclusive power to examine M&A with the Community dimension.

the EU case law, that evolved as a result of the Regulation are discussed in chapter three.

In chapter four, M&A is approached from the business administration perspective. It investigates the impact that M&A have on various groups of stakeholders: shareholders, employees, customers etc. Furthermore, possible problems in coordinating cultural differences are identified.

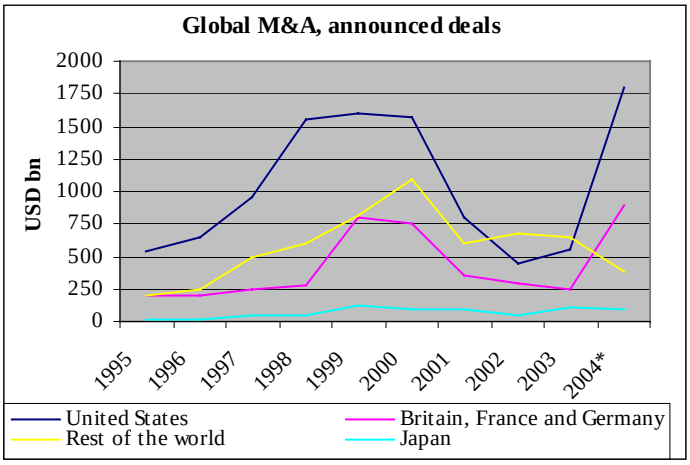
Chapter five investigates the purpose of merger control. Firstly, it is examined whether M&A actually contribute to increased company value or if they deserve the bad reputation they have gained in the last couple of years. Secondly, it discusses the dilemma whether competition or competitors must be protected. Finally, it is argued that it is ultimately the customers' satisfaction that gives a meaning to any M&A.

Chapter five provides closure remarks, underlining the most significant conclusions reached throughout the whole thesis.

2. RATIONALE BEHIND THE M&A

Throughout the history, M&A peaks unmistakably corresponded with technological developments (mass transportation infrastructure, electricity, information system networks, etc). Although the phenomenon of mergers can be traced back to the beginning of the 20th century, M&A have become increasingly popular over the last few decades. Prior to 1973, there was so little activity in cross-border M&A that the US Department of Commerce did not even bother to systematically collect specific data on foreign transactions.[7] In 2001, approximately 30% of all announced M&A in the USA had a cross-border character, which was a considerable increase compared to the 1970s and 1980s when the average was around 15%.[8] The value of globally announced M&A is constantly much higher in the USA compared to the rest of the world, but in recent years the EU has begun to catch up (Figure 1). Increased global competition allows only the most powerful companies to survive, which has ultimately contributed to the formation of corporate groups, both through domestic and cross-border M&A.

Figure 1. Value of globally announced M&A, 1995-2004



Source: The Economist[9]
* Until February 17, annualised

There are occasions when companies do not want to cooperate, but sometimes that might be the only appropriate response to cope with the harsh market competition.

[7] Weston, J.F., Chung, K.S. & Hoag, S.E. (1990), Mergers, Restructuring, and Corporate Control, p. 420
[8] Economic Report of the President and the Annual Report of the Council of Economic Advisors (2002), p. 103
[9] "Mergers and acquisitions: When battles commence", The Economist, 21/02/2004, p. 65

Companies fear, with a good reason, that competitors would take advantage of any missed opportunity. For example, after Boeing agreed to create a joint venture with three Japanese companies (Kawasaki, Mitsubishi and Fuji), its president admitted: "We would rather work with them than have somebody else work with them and against us."[10] Although controversial, this is probably the most honest explanation why companies cooperate. Nevertheless, a number of uncontested grounds for M&A can be identified.

2.1. Reasons for cross-border M&A

Relevant literature offers a comprehensive insight into the various reasons for M&A. Sometimes companies have rather different motives to engage in M&A depending on their individual strategies, but it seems that most of them are attracted by some main features that M&A can generate. The following listing is among the most exhaustive ones, and therefore it will be discussed as relevant.[11] Some of the motives do not relate to any differences between international and domestic M&A, instead they are considered as relevant for both.

A) Growth.

Growth is undoubtedly the most quoted reason for M&A in the literature, and according to some studies more than 90% of all M&A are aimed to achieve growth.[12] It can be argued that growth by M&A has an advantage over internal growth. It takes considerably less time to acquire already existing knowledge and technologies than to spend years by letting a competent in-house department develop similar products or services. Cross-border growth by M&A can generate even further advantages, provided that the target company in the host-country is familiar with local conditions, which could subsequently become a source of competitive advantage for the newly created concentration. Furthermore, achieving growth is essential for a few additional reasons:

- To achieve long run strategic goals

[10] Weston,J.F. & Chung,K.S. & Hoag,S.E. (1990), Mergers, Restructuring, and Corporate Control, p. 348
[11] List from Weston,J.F. & Chung,K.S. & Hoag,S.E. (1990), p.425; independent of the following discussion
[12] Deloitte & Touche (2000), Solving the Merger Mystery: Maximizing the payoff of Mergers and Acquisitions, p.7

- For growth beyond the capacity of oversupplied domestic markets
- Market extension abroad and protection of market share at home
- Size and economies of scale required for effective global competition

B) Diversification.

- By product line

Throughout the history, it became obvious that some of the most expensive M&A were in fact strategic bargains, whose benefits significantly outweighed invested capital. In 1960's and 1970's, a premium of 10-15% was typically enough; nowadays the M&A premiums are several times higher than the real market value of a target company. However, when companies expand across different product markets, they are obliged to pay attention to the potential strengthening of a dominant position. Conglomerate effects are often of particular importance in cases where the merging parties are already dominant in one market, and where this dominant position through various means can be leveraged into a neighbouring market or the dominant position even reinforced by the creation of a dominant position in a neighbouring market.[13]

In 1998, Nestlé paid £2.5 billion to acquire Rowntree, a company whose net assets were valued at only £300 million.[14] Although the cost was eight times higher than the real market value, Nestlé explained to its shareholders that the deal was a true bargain. Rowntree owned some well-known brands, like Kit-Kat chocolate, and it would have taken significantly more funds and time for Nestlé to internally develop something alike. Nestlé's main strategic objective is the acquisition of well-established brands and constant expansion in the product line. It currently owns Perrier, Sanpellegrino, Maggy, Mövenpick, Friskies and many other trademarks.

- Geographically (cross-border)

Once a company decides to expand internationally, it is possible that more than pure business interests would come into sight. It is almost certain that policy makers will become interested in how the presence of a foreign company would affect a domestic

[13] Faull, J., Nikpay, A. (1999), The EC Law of Competition, ph. 4.159
[14] Temporal, P. (1999), Branding in Asia: The Creation, Development and Management of Asian Brands for the Global Market, John Wiley & Sons (Asia)

market. In a scenario of the perfect economic integration and the Single European market, a distinction between domestic and cross-border M&A should not exist, but one must be aware of vibrant disparities in national interests. Reaction intensity largely depends on the previous M&A experience and the market culture. Anglo-Saxon countries are more opened to any kind of takeovers whereas Continental European countries are more protective towards domestic industries.[15]

One of the alternatives for M&A could be to construct an entirely new plant. However, it is proven that cross-border M&A can generate less risk than if a company decides to expand on its own. This is due to the fact that one of the merging companies is already present on the host-market, with established business networks, developed routine and awareness of the specific market conditions. Customers are also expected to be more loyal to domestic company names and trademarks. Therefore, it is more likely that they will accept a concentration between a domestic and a foreign company, rather then a purely foreign company that just penetrated the market. Initial market research can be built on already existing estimations and thereby enable a smoother initial phase of M&A.

C) Extend advantages through differentiated products.

A balance between product standardisation and product adaptation is crucial in the international environment. A merger between a domestic and a foreign company may be the ideal approach to satisfy the existing market demand and simultaneously introduce innovation. It is acknowledged that customers' preferences differ across the world, and therefore it can be concluded that the more differentiated the product line is, the more needs a company will be able to satisfy. However, some companies experienced that a too broad product line diversification might cause organizational difficulties. For example, Unilever, who is a supplier of food, home and personal care products, had to downsize its product line from 1600 to 400 brands in the last three years. Nevertheless, once the optimal balance is found, M&A could certainly provide the company with increased growth.

[15] Colin Mayer (2000), Developing the rules for corporate governance", Mastering Management, p.6

D) Technology.

Acquiring companies with well-developed technological infrastructure and highly productive R&D departments became increasingly important as the global competition increased. When Swedish Volvo Construction Equipment acquired Korean Samsung Heavy Equipment in 1998, it did not only ensure a smoother approach to the Asian market, but also it made sure to improve its technological expertise by implementing acquired knowledge into the already exiting capacity. On the other hand, Samsung could benefit from another set of technical solutions previously developed by Volvo. As a consequence, the newly created company can unite the sources of competitive advantage, integrating them into the most favourable combination.

E) Differential labour costs, productivity of labour.

Economic theory predicts a movement of production towards the countries with lower labour costs. This issue is currently emphasised in the light of the latest EU enlargement that took place in May 2004. Western European states feel threatened that their companies might find it more profitable to relocate the production units to the new Member States in the Central and Eastern Europe. Such predictions are based on the fact that the average hourly costs in the old Member States is €22,21, whereas it amounts to the average of €4,2 in the ten new Member States.[16] However, recent analyses show that this is unlikely to happen due to the low labour productivity in the new Member States, €16,7 (in gross value added at current prices per person employed, in thousands), in comparison with the old Member States' productivity of €57,6.[17] Despite these considerations, the M&A potential between the old and the new Member States should not be underestimated. The ten new countries form a large market that is still relatively unexplored and unsaturated with fierce competition.

[16] "A Plus and a Minus", The Wall Street Journal Europe, 16-18/04/2004, p. A7: Hourly labour costs are the highest in Sweden (€28,56), followed by Denmark (€27,10) and Germany (€26,34), whereas the same costs are the lowest in Latvia (€2,42), Lithuania (€2,71) and Estonia (€3,03). The scale follows a clear division between the two groups of countries, with the exception of Portugal, which has slightly lower costs than Cyprus and Slovenia.

[17] Ibidem: Average labour productivity is significantly higher in the old Member States. Luxemburg is placed ahead (€90,5), followed by Ireland (€81,6) and Denmark (€68,0). Once again, Baltic countries show the lowest values: Latvia (€10,7), Estonia (€12,0) and Lithuania (€12,9).

F) Resource-poor domestic economy.

Merging with or acquiring a foreign company may provide access to resources not obtainable in the home country. This is usually a motive for vertical mergers, where the main aim is to assure an uninterrupted chain of supply. Vertical mergers will be further discussed in chapter four.

G) Government policy.

Governmental policies and incentives may be a significant factor in attracting foreign investments. The Treaty clearly prohibits any quantitative restrictions on imports and exports between the Member States.[18] However, governments may incorporate certain measures in the national monetary and fiscal policies in order to make the investment on their territories more or less attractive. For example, Ireland has already established itself as an investment paradise with a low company tax rate. Most of the newly joined Member States have even lower tax rates, following the lead by Estonia that does not even collect this type of tax.[19] Circumventing, or aiming for, such governmental policies could be an important consideration when choosing a partner for M&A.

H) Political and economic stability.

Although the EU Member States are relatively stable both in political and economical aspects, certain turbulences still occur. When the UK, Spain, Italy and a few other Member States decided to send their military troops to Iraq in March 2003, this was perceived as a political risk that dramatically changed investors' perceptions. Only a week before the war, the European stock markets touched their lowest point since the mid-1990s.[20] At the time, it was hard to predict the duration and the range of the Iraq crisis, but it was clear that it was the companies incorporated in Member States less involved in the war that became more attractive to investors.

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[18] Consolidated version of the Treaty Establishing the European Community, as amended by the Treaty of Nice, Articles 28-31EC

[19] "Skattekrig i nya EU", Dagens Industri, 04/05/2004, p.15: The highest company taxes are charged in Germany (38%), Italy (37%), Spain (35%), France (35%) followed by the rest of the old Member States, whereas the lowest tax rates are to be found in Estonia (0%), Cyprus (12%), Ireland (12,5%), Latvia (15%) and the rest of the new Member States. The only exception is the Czech Republic that has a slightly higher rate than Luxemburg, Greece and Malta.

[20] "Markets set for week of turmoil" in BBC News, 09/03/2003

Considerations.

Due to the fact that companies are operating in various market environments that demand various responses, the above-presented list is far from exhaustive. Moreover, internal organisation and strategic goals differ between companies, making it complex to classify all the motives into only few categories. In the light of the classification given by Larsson, all the above-mentioned motives can be characterised as economic ones.[21] They are given here as most relevant because large-size M&A, which are the primary focus of this thesis, are most likely to be concerned with economic considerations due to large sums of money involved. Moreover, the first four motives listed (A–D) are related to microeconomic factors, while the rest (E–H) are dependent on the macroeconomic environment.

2.2. Available alternatives to M&A

As indicated above, throughout the history, there have been numerous reasons for M&A. However, in many cases it can be complicated to evaluate whether M&A truly is the best choice for a company to reach its goals. Speculations about the potential outcome of other available alternatives are often impossible since theoretical forecasts can rarely predict "surprise" elements that are likely to come forward during the actual process. M&A can be extremely complex, especially if they should combine highly diversified operations and structures of two large companies into one optimal unit. Integration failure of only one element, such as financial planning or human resource management, may cause a breakdown of the whole action. Proper preparation is even more crucial for cross-border M&A, since they often involve more risks and therefore are also organizationally more demanding. On the top of the high-risk nature of M&A, cultural differences might bring about immense unforeseen complications.

Before companies can be absolutely sure that M&A is the best option to satisfy their goals, other options must be considered. Even if a few alternatives may be identified, they will only rarely correspond to the effects gained by M&A. If a company chooses

[21] Larsson, R. (1990), Coordination of Action in Mergers and Acquisitions: Interpretive and Systems Approaches towards Synergy, p. 198: "Economic rationality refers to motives for increasing the economic value of the firm, while personal rationality refers to motives for increasing various forms of personal gains for leading actors. Organizational rationality refers o motives for controlling resource dependence to reduce uncertainty. "

internal growth, it will retain its full independence, but this also means that it might not benefit from otherwise positive M&A synergies. Joint ventures comprise elements of both M&A and internal growth, but also some distinct features that make them attractive. Although full functioning joint ventures are within the scope of the Merger Regulation, they are considered here only as an alternative to M&A.[22]

2.2.1. Internal growth

Depending on the final goals and the competitive situation on the relevant market, companies should assess whether it is more profitable to engage in M&A or to develop internally. In his study, Zejan has concluded that the probability of choosing M&A instead of a brand new investment is higher the more diversified the company is in its product line.[23] Choosing internal growth would mean substantially longer time to develop competences that can satisfy all product lines. In a case where a company would focus only on one product line, competitors would be expected to take an advantage of such a situation, trying to increase dominance in the market segments not covered by the company's investment. The same study has shown that the probability of takeover also seems to increase with the host country's income per capita and to decrease with the rate of growth of the host country' GDP and the growth in industrial production in the industry entered.

However, many companies employ a strategy that combines both internal growth and M&A. For example, Volvo Group established the corporate strategy by dividing its operations into eight business areas, which jointly form the leader corporation in developing and manufacturing transportation vehicles of various kinds. Although most of its units are highly decentralised, R&D operates on a higher level and it delivers results to all the business areas within the Group. Newly introduced EU environmental standards for buses and trucks forced Volvo to develop engine technologies to reach the significantly lower level of fuel emission. Although it was not its primary concern, the Construction Equipment unit was also able to introduce these technologies well ahead

[22] Council Regulation (EEC) No 4064/89, Article 3(2): "The creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity shall constitute a concentration within the meaning of paragraph 1(b) of the Regulation."
[23] Zejan, M.C. (1988), Studies in the behaviour of Swedish multinationals, p. 51

of upcoming emission legislation for the construction business. In the same time, it relied on frequent M&A to gain additional knowledge and competences to better satisfy the customers. It should be remembered that M&A can combine resources in a way to increase the total competitiveness, but it may still be necessary for the newly merged company to invest in internal growth in order to link the combined parts.

2.2.2. Joint ventures

Numerous companies prefer joint ventures to M&A. Such decisions are influenced by the wish to explore the benefits of collaboration with others but in the same time to retain the independence. When two companies agree to form a joint venture, they usually create a new unit to carry out the specific project, but remain operating separately. This is a way to avoid enormous costs of the complete M&A, and in the same time establish the cooperation in the preferred business area. Joint venture motives can be rather similar to M&A motives, but the emphasise is placed on the limited duration and scope.[24] For cross-border considerations, e.g. when a company is penetrating a completely new market with distinct characteristics, investing large amounts of money might be risky. Therefore, establishing a joint venture with a company in a host country could reduce risks by relying on the host-country company's knowledge about the local conditions. In the same time, it is easier to withdraw from the operation in case the plans do not develop as expected. Moreover, in extensive projects, joint resources of two companies could create synergy effects, normally characteristic for M&A (financing, knowledge, management, marketing etc). In theory, a company can be involved in dozens of joint ventures simultaneously, depending on the company and industry.

Although M&A can face numerous problems in integrating two distinct businesses, the two previously independent companies realize that the profits will be shared, which is a good motive to increase the cooperation. On the other hand, companies that participate

[24] The main reasons for joint ventures: 1) to increase insufficient financial or technical ability to enter a particular line of business, 2) to share technology and/or generic management skills in organization, planning, and control, 3) to diversify risk, 4) to obtain distribution channels or raw materials supply, 5) to achieve economies of scale, 6) to extend activities with smaller investment than if done independently, 7) to take advantage of favourable tax treatment or political incentives (particularly in foreign ventures); Weston, J.F. & Chung, K.S. & Hoag, S.E. (1990), Mergers, Restructuring, and Corporate Control, p. 334

in a joint venture are interested in collecting as much benefits as possible from it. Moreover, it has been spotted that each company tends to act in a way to limit gains of the other company. Considering that the companies are still competitors, despite the on-going common project, rivalry between them should not be underestimated. Therefore, joint ventures are less often a direct threat to competition. On the other hand, involvement in a joint venture might lessen the desire of companies involved to compete with each other or, even worse, they might find it easy to engage in exchanging information on prices. In conclusion, there is no safe way to carry out organizational changes. High risks are involved in all kinds of deals; ultimately it is the potential benefits that make it worth taking the chance.

2.3. Towards realisation

After defining the initial motives and describing other alternatives to M&A, the question of realisation remains. Firstly, a number of competition requirements will have to be satisfied, which will be discussed in chapter three. Large-scale M&A transactions will have an influence on different stakeholders and that will be discussed in chapter four. Finally, these two aspects will be connected in order to show if the consumers can benefit from the current legislation and if companies are well adapted to the market.

3. LEGAL IMPLICATIONS

After the initial phase of cross-border M&A is thoroughly worked out, companies still have a long way ahead before being able to realize their intentions. Namely, the EU legal requirements must be satisfied before a merger or an acquisition can be granted a clearance.[25] Although the competition rules may seem to be clearly formulated in theory, there is a considerable lack of certainty once they should be applied in practice. The wording typically follows general principles arising from the EC Treaty, but its scope is repeatedly challenged. This chapter discusses the M&A effects in the EU from the legal perspective, highlighting the problems that companies have been faced with since the Merger Regulation 4064/89/EEC was adopted in 1989. After it became applicable in September 1990, the European Commission was empowered to carry out the one-stop-shop control. The Regulation was considered to be a modern and effective tool for merger supervision. The new Merger Regulation 139/2004/EC entered into force in May 2004, creating even higher transparency of the EU competition rules. The EU case law is continuously evolving, sometimes in rather unexpected directions, often raising a lot of criticism. Nevertheless, it has provided valuable guidelines for the future. It appears that the Commission is seeking to encourage cross-border M&A, but the companies, especially the ones from the continental Europe, are limiting their positive attitudes concerning mergers and friendly takeovers. Since the new Regulation did not introduce any changes to decrease hostile takeover defence systems, companies may still incorporate specific provisions into their internal statutes to limit acquirer's power and possibly even refrain it from the planned takeover.

3.1. The Evolution of the Merger Regulation

The Treaty of Rome entered into force in 1958, outlining the newborn legal system of the European Communities. Although it contained Articles on competition policy (Articles 81-89 EC), it has never explicitly mentioned if, or how, they should be applied

[25] Council Regulation (EEC) No 4064/89; Article 2(3): "A concentration which creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it shall be declared incompatible with the common market."

to mergers.[26] In the early days this was not perceived as a significant problem because mergers were not extensively exercised business practices. Nevertheless, soon it became obvious that there was an immense gap in this part of the law. In its 1966 Memorandum, the Commission stated that Article 82 EC will be infringed where one an undertaking that is already holding a *dominant position* in the Community, or a substantial part of it, acquires a competitor, even if the ability to make the acquisition is not attributable to, or dependant on that existing dominance.[27] Thereafter, the European Court of Justice (ECJ) began to invoke Articles 81 EC and 82 EC in merger cases to create some order, starting with the Continental Can judgement delivered in 1973.[28]

Continental Can was a US company that held a dominant position on a specific part of the metal packaging market in the EU through its European subsidiary Europemballage. After Europemballage acquired a Dutch company called TDV, the Commission found the practice to be an abuse of dominant position, prohibited by Article 82 EC. Continental Can appealed to the ECJ, arguing that the Commission had exceeded its powers by interpreting a merger case in the light of Article 82 EC, questioning whether the Commission has legislative power over the companies incorporated outside the Community and claiming that there were some substantial procedural irregularities in the decision. The ECJ smashed most of the applicants' arguments, stating that both Europemballage and Continental Can are under scrutiny of the EU competition law and

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[26] *Article 81 EC* prohibits "all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market…" *Article 82 EC* states that "any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States…"

[27] Cook, C.J., Kerse C.S. (1991), EEC Merger Control: Regulation 4064/89, p.2;
The concept of the *dominant position* was defined in the United Brands v Commission case (so called 'Banana case'), Case 27/76, 14/02/1978 in the Paragraph 65 of the ECJ judgement: "The dominant position…relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately its consumers". This case is not of the primary concern for this paper and as such it is not further discussed. Its relevance is much more significant for interpreting the effects of Article 82 and abuse of dominant position than for the M&A discussion.
Economists also deal with this concept: "Higher prices to consumers as a result of reduced competition are due to what economists call monopoly power, that is, the power of a single seller to affect the market price. Lower prices to input suppliers as a result of reduced competition are due to what economists call monopsony power, that is, the power of a single buyer to affect the market price. Both effects are exercises of market power, and thus a concern of competition policy." in the Economic Report of the President and the Annual Report of the Council of Economic Advisors (2002), p. 107

[28] Europemballage Corporation and Continental Can Company Inc. v Commission of the European Communities, Case 6/72, 21/02/1973;

that Article 82 EC could be applicable in merger cases.[29] However, the ECJ held the Commission responsible for the lack of presented evidence and it finally ruled in favour of the applicants. According to the ECJ, the Commission wrongly considered that Continental Can was dominant over the market supply without considering potential substitutes and competitors. Even if other companies were producing dissimilar products it might have been relatively simple for them to adapt the machinery to produce goods similar to the rival's. The significance of this judgement lies in the finding that Article 82 EC could be applied to at least some mergers, although not in this particular case. From that moment on, mergers were characterised as practices capable of reducing the competition on the Community market. The case has also set the guidance that both the *behavioural abuse* (operations leading to harm the consumers) and *structural abuse* (actions leading to weaken the competitive market structure) will be considered as breach of Article 82 EC. Although the judgement seemed to be revolutionary at the time, the Commission never took a formal decision based on it in its later proceedings.[30] However, the Commission had to wait almost seventeen years before the Merger Regulation had come into force and since then it has no longer applied Articles 81 EC and 82 EC to M&A.

The most radical change inaugurated by the Merger Regulation was the one-stop-shop principle. All the mergers with Community dimension became subject to the mandatory pre-notification of intentions to the Commission. The Regulation has an impact on the EU cross-border M&A between companies with a combined worldwide turnover of at least €5 billion and a Community turnover of at least €250 million for at least two of the companies.[31] In exceptional circumstances, the Commission may refer a concentration with Community dimension to a Member State's national authority or it can review a concentration that does not have a Community dimension.[32] Although the Commission

[29] Paragraph 16 of the ECJ judgement in the Continental Can case states: "Community law is applicable to such an acquisition, which influences market conditions within the Community. The circumstance that Continental does not have it registered office within the territory of one of the Member States is not sufficient to exclude it from the application of Community law."
Paragraph 26 of the same judgement states: "Abuse of Article 82 may therefore occur if an undertaking in a dominant position strengthens such position in such a way that the degree of dominance reached substantially fetter competition, i.e. that only undertakings remain in the market whose behaviour depends on the dominant one".
[30] Korah, V. (1997), EC Competition Law and Practice, p. 262
[31] Council Regulation (EEC); No 4064/89, Article 1(2)
[32] Council Regulation (EEC) No 4064/89, Article 9, so called *German clause*

was given the exclusive power to halt some mergers, the principle is still largely appraised as beneficial among the EU companies due to reduction of costs, bureaucracy and legal uncertainty. In the absence of such legislation, the diversity of legal systems and national procedures across the EU would substantially prolong the clearance time in comprehensive cases, which is economically unsatisfactory on the modern and fast-moving markets. During the years, scope of the Regulation was extended from mergers to other types of concentrations, such as acquisitions and joint ventures. Over the time, it has evolved in a way to catch behaviours like *collective dominance* or oligopolies (Nestle/Perrier and Kali und Salz/MdK).[33] This will be discussed in more detail below.

After many years of negotiation to upgrade the M&A legislation, Council Regulation (EC) No 139/2004 was adopted in January 2004 and entered into force on 1 May 2004, on the same date as the EU enlargement, having direct effect in all the 25 Member States. The new Regulation is designed to equip the EU with a modern, flexible and efficient legislation to cater for the interests of 450 million consumers.[34] Its creators obviously kept in mind the difficulties that could eventually arise; hence certain mechanisms are integrated to make M&A more straightforward in the expanded EU. To be specific, companies are now able to apply for the one-stop-shop if they have to notify in three or more Member States. Also, the substantive test covers all the anti-competitive practices that result in higher prices, less choice or innovation, and it explicitly states that not only single but also collective dominance are caught. Nevertheless, the main purpose remained unchanged, meaning that the Commission will investigate possible creation of market dominance and restriction of competition in the interest of consumers.

3.2. Circumventing the Merger Regulation

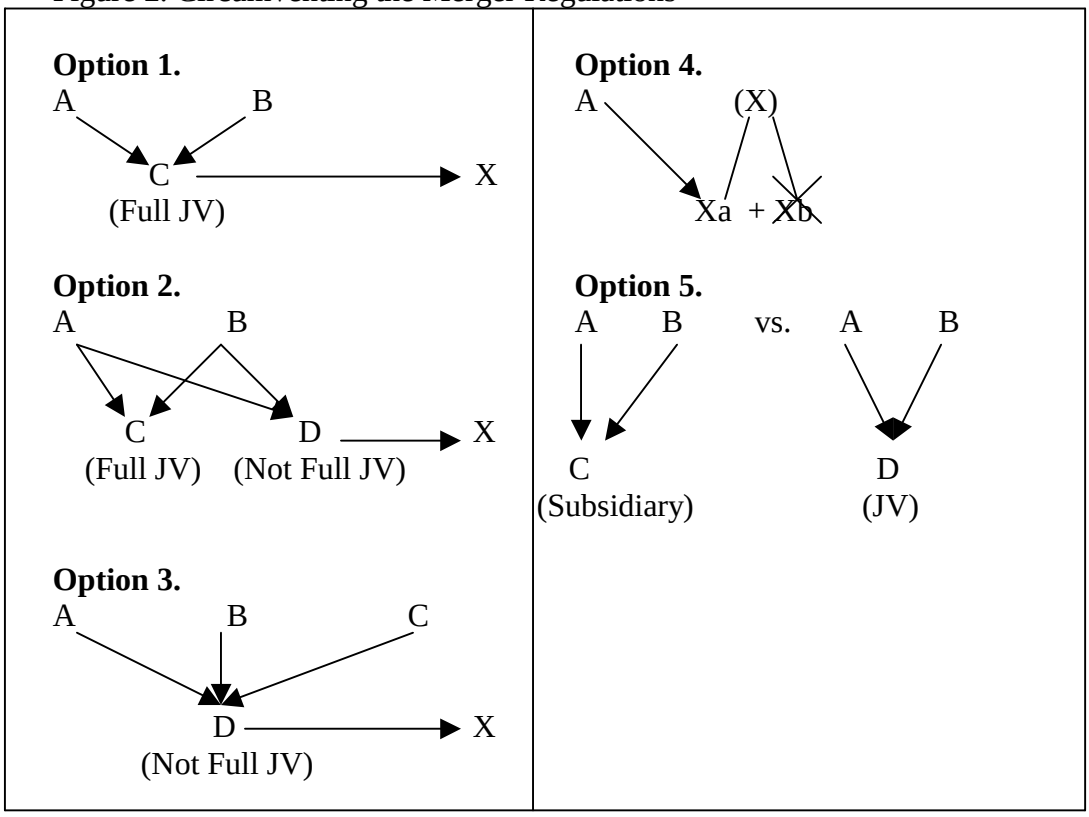
It is important to notice that only concentrations with a Community dimension will fall under a scrutiny of the Merger Regulation. Companies' interests differ, and therefore it

[33] Kali+Salz/MdK/Treuhand, Case No IV/M.308, 09/07/1998; Nestlé/Perrier, Case No IV/M.190, 05/12/1992

[34] Opinion by Competition Commissioner Mario Monti, Commission's press release IP/04/70 "EU gives itself new merger control rules for 21st century", 20/01/2004

can be expected that some would like that their M&A operations are examined under the Regulation, whereas other would prefer to notify the M&A to national competition authorities, depending on where it is more likely to obtain a clearance. Although the decision depends solely on turnover, in some cases it will be possible to circumvent what seem to be clear provisions.[35] Broberg suggests two basic options in his study: structure a deal in a way to arrange the undertakings concerned (through a joint venture or by involving an additional undertaking) or in a way to gradually structure the calculation of turnover (reducing/enlarging company's operations or again, through a subsidiary).[36] These methods are applicable only in a certain number of cases, but they provide interesting options for companies that can explore such possibilities. A simplified graphical scheme of Broberg's findings is presented in Figure 2, which is further discussed below.

Figure 2. Circumventing the Merger Regulations



[35] As stated in the previous chapter: The Regulation has an impact on the EU cross-border M&A between firms with a combined worldwide turnover of at least €5 billion and a Community turnover for at least two of them of at least €250 million. An exception is when each undertaking concerned achieves more than 2/3 of the turnover in the same Member State.

[36] Broberg, M.P. (1998), The European Commission's Jurisdiction to Scrutinise Mergers, ch.9

Firstly, it can be assumed that the undertakings *A* and *B* have an aggregate worldwide turnover worth more than €5 billion. They are members of the same group and they have established a full-functioning joint venture, *C*. *A* and *B* can decide to acquire *X* (which does not meet the Community-wide thresholds of €250 million) through their joint venture *C*, in order not to be considered as undertakings concerned. In this way, only *C* and *X* will be the undertakings concerned, where only *C* meets the thresholds, and therefore the concentration will not have a Community dimension (Option 1 in the Figure 2). However, if *A* and *B* want to give Community dimension to the concentration, they can establish a new, non-full functioning joint venture *D* for the sole purpose of acquiring *X*. In this situation, the undertakings concerned will be *A*, *B* and *X* (D cannot be considered since it is not a full functioning joint venture), and they will satisfy the condition of at least two undertakings meeting the Community-wide turnover thresholds. Therefore, the concentration will now have a Community dimension (Option 2 in the Figure 2).

Secondly, the 'two thirds rule' leaves a gap that can be exploited by involving an additional undertaking to the concentration. Namely, it can be assumed that undertakings *A* and *B* wish to acquire *X*. All of them achieve more than two thirds of the turnovers in one Member State. Despite the turnovers being higher than €250 million in the Community, the concentration would be up to Member State authorities to clear. However, undertakings A and B might believe that it will be easier to get a clearance from the Commission. In order to get the Community dimension, *A*, *B* and *C* can decide to set up a temporary joint venture *D* for the sole purpose of acquiring *X*. Undertaking *C* achieves most of its turnover in another Member State, not meeting the Community thresholds. In this situation, the undertakings concerned do not all have more than two thirds of a turnover in one Member State and the concentration has gained Community dimension. Therefore, in some cases it will be desirable to add an undertaking of insignificant size from another Member State, which will not require significant costs, to get the Community dimension. (Option 3 in the Figure 2).

Thirdly, downsizing or expanding the business operations also provides a number of possibilities to adjust the turnover value. If an undertaking *A* plans to acquire *X*, it may demand that X sells one part of its business prior to acquisition. Primarily, both

undertakings were meeting the thresholds, but after *X* divests the required operations, these activities will be excluded from turnover calculations. Thereby, undertaking *X* will no longer meet the thresholds and the deal will lose its Community dimension. However, this is only possible if conditions about business divesting are imposed before the notification to the competition authorities. On the other hand, if a company first notifies the Commission and then announces such a request, the whole turnover will be calculated as relevant. This method is among the easiest ones, since it only depends on the time sequence (Option 4 in the Figure 2).

Finally, by including a subsidiary in a transaction, it is possible to adjust the (non)-existence of the Community dimension. An undertaking *A* can agree to the shared ownership of its subsidiary *C* with another undertaking *B*. The undertakings *A* and *C* meet the Community thresholds, whereas *B* does not have any prior operations in the Community, but it meets the worldwide thresholds. In this scenario, the transaction will have the Community dimension, with *A*, *B* and *C* being undertakings concerned, two of which meet the Community thresholds. However, if *A* and *B* want to avoid that, they can set up a new non-full functioning joint venture *D*. Now, the Commission will consider only *A* and *B* as undertakings concerned, and since only *A* satisfies the Community thresholds, the whole concentration will not have the Community dimension (Option 5 in the Figure 2).

Apart from the above considerations, additional problems as regards to thresholds might occur. Assumingly, two smaller companies, partly owned by big corporations, decided to merge. Alone, the companies do not meet the thresholds, but the groups they belong to do. Depending on the internal agreements and ownership nature, the potential merger might have to be notified to the Commission. In that case, the cost of notification may reach, or even exceed, the cost of the whole transaction.

Described possibilities of circumventing the Merger regulation are only some of the options, leaving more combinations opened. Of course, such options will be feasible in a limited number of cases; however they are capable of providing undertakings with potentially large benefits. Circumventing the rules is not a genuine ambition when practising M&A, but such options should not be disregarded as they might make the

difference between success and failure right from the start. It is by no means suggested here to go beyond what the law allows.

3.3. The European Commission and one-stop-shop principle

Ever since the implementation of the Regulation and until today, 213 cases have been abandoned for different reasons, but the Commission actually prohibited only 18 of them (Figure 3).[37] Moreover, one of the banned cases (namely Tetra Laval/Sidel) was ultimately given a permission to merge after the appeal to the Court of First Instance.[38] This rather low number suggests that the Commission's objective is to encourage M&A activity. Assumingly, the primary intention is to integrate small industries of the Member States into the larger global competitors of the European Union. Although almost insignificant in number, the rejected cases have raised a lot of debates, questioning the legitimacy and plausible grounds in the Commission's reasoning.

A number of cases were subject to conditions that had to be met before M&A could be approved, but it was again the Commission that was willing to reach a compromise. One of the most recent cases where the Commission imposed such restrictions was a merger between Air France and KLM in 2004.[39] The merger that was heading to create a Europe's biggest airline raised competition concerns. The Commission argued that a merger between Air France and KLM could create a dominant position on several passenger and cargo routes. Barriers of market entry were considered to be high, especially at the Paris and Amsterdam airports, where both parties respectively enjoyed economies of scale. Granting more slots to competitor airlines could preserve the competition, but that could not be easily achieved since the two airports were already

[37] List taken over from Levy, N. (2003), "EU Merger Control: From Birth to Adolescence", World Competition, Kluwer Law International: Aerospatiale-Alenia/de Havilland (aircraft); MSG Media Service (telecommunications); Nordic Satellite Distribution (television); RTL/Veronica/Endemol (television); Gencor/Lonrho (platinum); Kesko/Tuko (consumer products retailing); Saint-Gobain/Wacker-Chemie/NOM (abrasive materials); Blokker/Toys "R" Us (toy retailing); Bertelsmann/Kirch/Premiere (television); Deutsche Telekom/BetaResearch (television); Airtours/First Choice (packaged holidays); Volvo/Scania, (trucks and buses); MCI WorldCom/Sprint (telecommunications); SCA/Metsä Tissue (household hygiene paper products); General Electric/Honeywell (aerospace engines, avionics, and aerospace components); Schneider Electric/Legrand (electrical equipment); CVC/Lenzing (man-made fibres); and Tetra Laval/Sidel (food and beverage packaging).

[38] Commission's press release IP/03/36 "Commission clears acquisition of Sidel by Tetra Laval Group", 14/01/2003

[39] Air France/KLM, Case No COMP/M.3280, 11/02/2004

congested. In order to proceed with the merger, the companies had to convince the Commission that competition would not be restricted. Both airlines offered to give up a number of take-off and landing slots at the airports in Paris and Amsterdam, as well as some of the flights between Europe and the USA. Moreover, the Dutch and the French governments provided guarantees to refrain from regulating prices and to give equal traffic rights to competitors' carriers. The Commission was satisfied with these propositions and it finally agreed to clear the merger. Numerous cases alike suggest that companies are usually prepared to sacrifice parts of their businesses in order to gain M&A clearance from the Commission. Therefore, the market dynamic is subject to continuous changes, as the companies tend to join, divert or divest their business into various directions. Competitors can easily become partners and vice versa, keeping the competition monitoring authorities constantly alert to possible competition impediments.

Figure 3. European Merger Control under the Merger Regulation, 1990-2004

Year*	**Notified to the Commission**	**Final decisions****	**Prohibited or abandoned*****
1990	12	7	2
1991	63	60	6
1992	60	61	13
1993	58	57	7
1994	95	91	13
1995	110	109	15
1996	131	125	18
1997	172	142	21
1998	235	238	21
1999	292	270	19
2000	345	345	23
2001	335	340	25
2002	279	274	18
2003	212	231	9
2004	67	57	3
Total	**2466**	**2407**	**213**

Source: European Commission[40]
* Data from September 21,1990 until April 30, 2004
**Both positive and negative
*** Withdrawn operations, operations out of the scope of the Merger Regulation, decisions fully or partially referred to the Member States and prohibited operations

[40] European Commission, European Merger Control - Council Regulation 4064/89, Statistics, 27/04/2004

A more debated issue is the Commission's power to examine mergers between non-EU-based companies with substantial operations on the EU market.[41] Moreover, the EU Commission and the US Department of Justice signed an agreement on co-operation in competition law enforcement in 1991, which was further revised in 1998.[42] The agreement calls for notification and co-operation in non-confidential information sharing when both the US and EU authorities have a common interest.[43] Using these powers, the Commission had blocked a merger between two US companies for the first time in June 2000, namely between WorldCom and Sprint.[44] It held that the two telecommunication companies would create a dominant position on their relevant product market in the entire EU. Thereby, remaining competitors and customers would become fully dependant on the newly merged company, both as regards the market conditions and the prices. Despite being currently placed under a bankruptcy procedure, WorldCom is now appealing against the decision questioning whether the prohibition was legal from the start. One day before the Commission delivered its decision, the companies announced the intention to withdraw their application, after being warned about the negative outcome.[45] However, the Commission argues that the decision was legally delivered since the two companies did not formally cancel their merger agreement.[46] American media has taken advantage of the situation, blaming the EU of favouring domestic industries and protecting them from global competition.

The Commission's rejection of the $40 billion worth GE/Honeywell merger raised even more controversy in 2001.[47] The Commission argued that the merger could lessen the competition in the aerospace engine sector and result in higher prices for customers in

[41] Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings, Preamble (5): "…Community law must therefore include provisions governing those concentrations which may significantly impede effective competition in the common market or in a substantial part of it."

[42] Agreement between the Government of the United States of America and the European Communities on the
Application of Positive Comity Principles in the Enforcement of Their Competition Laws, 4 June 1998

[43] Akbar J. (2002), Grabbing Victory from the Jaws of Defeat: Can the GE/Honeywell Merger Facilitate International Antitrust Policy Co-operation?, p. 9

[44] WorldCom/Sprint, Case No COMP/M.1741-MCI**,** 28/06/2000

[45] FindLaw: WorldCom Seeks to Annul EU Merger Ruling, 30/03/2004

[46] Commission's press release IP/00/668 "Commission prohibits merger between MCI WorldCom and Sprint", 28/06/2000

[47] General Electric/Honeywell, Case No COMP/M.2220, 03/07/2001

the medium term.[48] The debate arose around the fact that the US competition authorities had already approved the merger. The US Justice Department considered that the combined company could offer better products and services at more attractive prices than neither of them could offer individually, and that the merger would have been pro-competitive and beneficial to consumers.[49] However, the European Commission concluded that the merger severely would have reduced competition in the aerospace industry and ultimately result in higher prices for customers, particularly airlines.[50] Even the US president, George W. Bush, expressed his concern, stating that he "wanted the US companies to be fairly treated by the EU".[51] The European Competition Commissioner, Mario Monti, responded that the "decision is strictly a matter of law and politics, and that the nationality of the companies and political considerations have played and will play no role in the examination of mergers, in this case as in all others".[52] Whatever the reason for prohibition was, these discussions pointed out the necessity to coordinate worldwide competition policies in order to avoid, or at least reduce, future disagreements. The fact that the above-mentioned cases are more an exception than a rule should not mislead one to underestimate the impact of such disparities, resulting disagreements and placing the entire EU in an unfavourable position.

3.4. Collective dominance

Collective dominance is a relatively new concept investigated by the Commission in M&A cases. The main task of competition monitoring bodies is to ensure that potential formations of oligopolies, or even duopolies, do not distort the competition. In 1992, the Commission's decision in the Nestlé /Perrier case threw new light on a debate whether there should be a difference in assessing single and collective dominance.[53] The French mineral water supply market was occupied by three strong competitors: Nestlé, Perrier and BSN. After Nestlé announced the intention to acquire Perrier and sell some of its

[48] Commission's press release IP/01/855, "Commissioner Monti dismisses criticism of GE/Honeywell merger review and rejects politicisation of the case", 18/06/2001
[49] Economic Report of the President (2002), p. 126
[50] Commission's press release IP/01/939, "The Commission prohibits GE's acquisition of Honeywell", 03/07/2001
[51] BBC News: Q&A: GE's failed merger, 04/07/2001
[52] Commission's press release IP/01/855, "Commissioner Monti dismisses criticism of GE/Honeywell merger review and rejects politicisation of the case", 18/06/2001
[53] Nestlé/Perrier, Case No IV/M.190, 05/12/1992

resources to BSN, the Commission feared that Nestlé and BSN would create a duopoly and thereby restrict the competition. Nestlé /Perrier and its largest competitor BSN together held 82% market share. The companies contested the Commission's reasoning and questioned whether duopolistic dominance can be caught under the Merger Regulation. That was the first time the Commission gave a clear definition of what will be caught under this concept. Single firm dominance occurs where the concentration creates or strengthens a dominant position by the parties to the concentration whereas a collective dominance exists between the parties of the concentration and another party on that market.[54] Finally, it concluded that both situations are able to distort competition and are therefore contrary to the Community market objectives set out in the EC Treaty. Nevertheless, the companies negotiated a compromise with the Commission and the merger was cleared.

In 1993, a case known as Kali and Salz was notified to the Commission.[55] Kali and Salz was a subsidiary of the BASF chemical group operating on the potash and rock salt market. They planned to merge with MdK, the company operating on the same product market in former East Germany. However, the applicants were disallowed from merging due to the possible strengthening of collective dominant position held together with a French company, SCPA. They together held approximately 60% share on the relevant Community market, and even 100% in Germany. Subsequently, the French Republic appealed to the ECJ, questioning whether the collective dominance was under scrutiny of the Merger Regulation. Advocate General Tesauro went even one step further in expressing his disapproval, pointing out that nothing in the previous case law has indicated that the Commission has jurisdiction to rule about such matters: "I would be very hesitant to state that the Commission and the Court may, when applying and/or interpreting rules, fill any lacunae deliberately left by the legislature."[56] In 1998, the ECJ finally re-affirmed the Commission's standpoint that the collective dominance is covered by the Merger Regulation because it is capable of restricting the competition and therefore it has the same effect as the single dominance. However, the merger was ultimately cleared in spite of creating a duopoly between Kali/Salz and SCPA. The

[54] Craig, P., De Burca, G. (2003), EU Law: Text, Cases, and Materials, p.1051

[55] France v. Commission, C-68/94 & 30/95, 31/03/1998; and the Commission's final decision in the Kali+Salz/MdK/Treuhand, Case No. IV/M.308, 09/07/1998

[56] Opinion of Mr Advocate General Tesauro in the case France v. Commission, C-68/94 & 30/95, paragraph 87, 06/02/1997

positive decision was justified by the fact that one of the merging parties would otherwise bankrupt and be forced to exit the market, which would result in the same division of market share as if they merged. Nevertheless, the Commission accepted the '*failing company defence'* only in this case, demonstrating that companies should not be very optimistic in using such arguments to circumvent legal requirements.

The Commission's attitude towards collective dominance is undoubtedly firm, but the final outcome of the case largely depends on the circumstances. Mergers that create a concentration with more than 70% market share are most likely to trigger off an oligopolistic dominance review; concentrations creating shares between 50% and 70% are occasionally reviewed, and those under 50% would most likely not be a concern of collective dominance investigations.[57] For those companies that are genuinely interested in carrying out M&A as planned, the best approach so far was to negotiate with the Commission. Sometimes this requires selling off a few parts of the company to competitors. Provided that the gains outbalance the losses, a majority of the companies have been willing to make such sacrifices to be able to proceed as planned.

3.5. Hostile takeovers

Cross-border M&A can be problematic due to differences in national legislations and market cultures of the Member States, which is further enhanced in hostile takeovers. The Commission tried to introduce the 'takeover bids directive' in the area of the company law, but after more than a decade of negotiations, it remained only a draft. According to the Commission, the purpose of such legislation would be to create a playfield for takeover bids as a key for integrated Community capital market. However, Member States cannot reach a compromise in this field, realising that many of their companies will still have to grow in order to operate efficiently in the integrated market. The purpose of this chapter is to underline the significant national differences between Member States and to point out the strong political influences included in this type of acquisitions. Anglo-Saxon Member States were hoping that the new Merger Regulation would ban, or at least lower, vigorous anti-takeover defences at the Community level. However, mainly due to the German and Swedish opposition, the issue remained up to

[57] Hawk, B.E., Huser, H.L. (1996), European Community Merger Control: A practitioner's guide

the Member States to regulate. Regardless of how the Member States decide to deal with *poison pills* or *golden parachutes*, Community legislation will not interfere.[58] The fact that it was Germany and Sweden that wished to protect their national companies from foreign hostile takeovers has historical ruts. German corporate governance culture is characterised by strong relationships between its companies, national banks and unions, which subsequently make it more difficult for outsiders to pry into the heavily controlled and organized market. Hostile takeovers were practically unknown on the German market until Vodafone acquired Mannesmann. Swedish corporate governance, on the other hand, is more opened to takeovers, but it still employs dual voting schemes and circular ownership of stocks in order to exercise substantial ownership control.

As previously mentioned, the first time a foreign (British, in this case) company engaged in a large-size hostile takeover of a German company was when Vodafone acquired Mannesmann. The $202,8 billion worth deal was closed in 2000 and it became the most expensive takeover of all times.[59] However, it provoked a flood of rage in both countries. It became obvious that German national interests were at stake when chancellor Gerhard Schröder stated that "Hostile takeovers destroy a company's culture", whereas British PM Tony Blair reacted more in the British spirit by stating that "It is a commercial issue for the companies involved".[60] However, the British public raised the question of a possible existence of double standards on the Single European market. It became unclear if, and how soon, the Member States can overcome the gap in market cultures in order to establish a true European unity. This case suggests that cross-border mergers are not only subject to issues of business and legal concerns, but also political obstacles.

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[58] *Poison Pill* is a takeover defence mechanism. A company can issue securities to its stockholders and grant them the right to obtain a certain company share more favourably, which would as a consequence distort the control balance in the company and therefore make the company less valuable to predators. *Golden Parachute* is another type of a takeover defence mechanism where companies provide a payment to its top-management in a case of a takeover with the intention to make it less concerned about its own welfare and more about the stockholders' interests.

[59] It is followed by the $164,7 billion AOL/Time Werner takeover in 2001, $89,2 billion Pfizer/Werner-Lambert takeover in 2000, $78,9 billion Exxon/Mobil takeover in 1999, $76,0 billion Glaxo-Welcome/SmithKlineBeecham takeover in 2000 and so on. Data published in Gaughan, P.A. (2002), "Mergers, Acquisitions, and Corporate Restructurings", p.4

[60] "Europe's level playing field?" in BBC News, 24/11/1999; and "Blair steers clear of Vodafone hostile bid", in BBC News, 21/11/1999

Another case is currently raising the spirits in the pharmaceuticals industry. Since both Sanofi-Synthelabo and Aventis are French-based companies, the case is relevant to emphasise the political angle of M&A. Aventis rejected the Sanofi-Synthelabo's €47billion hostile takeover bid in January 2004, characterising it as financially inadequate. In April 2004, Sanofi increased its offer to €54billion which was enough for Aventis to accept the takeover.[61] When the merger is fully carried out, the companies will together become the third biggest pharmaceutical corporation in the world.[62] French Prime Minister Jean-Pierre Raffarin backed up the takeover and thereby contributed to the public opinion that creating one "national champion" would be better than allowing French companies to merge with foreign ones.[63] This highlighted that nationalism is not a forgotten concept despite the enhanced efforts towards full integration on the EU market. To emphasise political over judicial interests even further, the Sanofi-Synthelabo had to divest many of its products and geographical markets in order to get the Commission's approval, but nothing could keep it from carrying out the planned takeover.[64]

The Anglo-Saxon corporate system has a long history of both friendly and hostile takeovers. The British frustration over continental European business practices was touched upon above. The US law also allows companies to take advantage of anti-takeover mechanisms, however less explicitly than in the EU. In 1988, the Delaware court ruled that companies may decline hostile bid and instead accept lower, but friendly takeover bid by another company.[65] The revolutionary Delaware legislation is focused on protecting companies and it soon managed to attract more companies than any other US state. Today, half of all New York Stock Exchange listed companies are incorporated there, along with 60% of the *Fortune 500* companies.[66] In the context of

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[61] "Aventis and Sanofi set for merger" in BBC News, 26/04/2004

[62] Present market leader is Pfizer with €33,0 billion worth in sales, second biggest is GlaxoSmithKline with sales of €22,1 billion and Sanofi/Aventis would potentially be able to realize €16,2 billion in sales. Data published in "Aventis Scrambles to Find Defense to Takeover Offer" in The Wall Street Journal Europe, 27/01/2004, p. A1

[63] "Aventis Scrambles to Find Defense to Takeover Offer" in The Wall Street Journal Europe, 27/01/2004, p. A1; "France strikes a nationalistic note on Sanofi-Aventis" in the International Herald Tribune, 26/01/2004,; and "Bid to create French drug giant" in BBC News 26/01/2004

[64] Commission's press release IP/04/545, "Commission approves planned acquisition of Aventis by Sanofi-Synthelabo subject to conditions", 26/04/2004

[65] Revolutionary ruling that Time may reject Paramount's hostile offer and accept friendly "buyout" bid from Warner

[66] Gaughan, P.A. (2002), Mergers, Acquisitions, and Corporate Restructurings, p. 101

the EU cross-border M&A, legal differences should be kept in mind in order to be able to respond to them in the right time if necessary. For the companies incorporated in the EU market, and whose national legislation does not allow anti-takeover defences, it is valuable to know that they can still make use of such defences if faced with a hostile offer from a company based in another Member State that allows such mechanisms. Some of them, for example *poison pills*, can be adopted even after the company receives a hostile takeover bid.

3.6. Post – Enron considerations

A number of cases suggests that publicly available information, such as annual reports, are not sufficient to gather financial information about the target company in M&A. Companies, their lawyers and auditors are bound to apply international accounting standards truthfully, but accounting frauds, like Enron and WorldCom, point out that one should not unreservedly rely on all the published data. Enron is a US company with operations in the energy and communication sectors. Before its financial fraud was discovered in 2001, two cases involving the company's acquisitions of European companies approached the European Commission. Firstly, Enron notified its intention to acquire MG, a London based metal trader. The deal was granted a clearance in July 2000, after the Commission concluded that the companies were active in different markets at the time and therefore there was no concern about creating a dominant position.[67] The other case was Enron/Bergmann/Hutzler, where Enron intended to acquire the two German companies (parent and subsidiary) through its European subsidiary MGMR.[68] The Commission delivered its opinion in December 2000, clearing the acquisition after finding no competition concerns. Nevertheless, it can be argued that the acquired European companies, as it became clear after the bankruptcy, would have been better off if they remained independent or if they merged with another company. Objectively, the Commission could not have spotted the irregularities in Enron's financial reports, but it could be blamed for not investigating beyond them. Unfortunately, at the time no one could predict the forthcoming scandal, especially since Arthur Andersen, the respectable accounting firm, provided a guarantee that

[67] Enron/MG, Case No COMP/M.2006, 04/07/2000
[68] Enron/Bergmann/Hutzler, Case No COMP/M.2196, 07/12/2000

Enron is functioning well. Nevertheless, in 2002 Arthur Andersen's accountants were convicted for destroying documentation and evidence that would have been important in the Enron trial. How widely spread this fraud truly was is not yet known. In March 2004, a group of banks sued J.P. Morgan Chase, Citibank and Salomon Smith Barney, accusing them of helping Enron to carry out the largest fraud in U.S. corporate history.[69]

Nevertheless, due to stricter legislation and ever-harsher controls, choosing a partner for M&A is becoming more complicated. There are risks that companies can objectively anticipate, but it seems to be essential to "plan the unplanned". Over the last few years, worldwide markets experienced plenty of sudden changes, from currency crises to recessions, stock market collapses, terrorist attacks etc. Even though, all this came as a complete surprise, companies that had not overstretched their abilities could use preserved resources during the economic downturn. Keeping some additional forces in a company turned out to be especially important in the initial phase of a merger. Before two companies are truly integrated, they are extremely vulnerable, especially after spending large sums of money to make the merger happen. Therefore, managers who were aware of underlying risks and who did not disregard the warning signs, managed to avoid unpleasant experiences. In conclusion, annual reports should only be a basis for further research and by no means should they be the only determining material, especially when a lot of money is invested. M&A always involve a certain amount of risk and therefore, the better prepared the companies are and the better informed about each other they are, the higher potential the deal has.

[69] Reuters, "Banks Sued Over Prepays in Enron Scandal", 23/03/2004

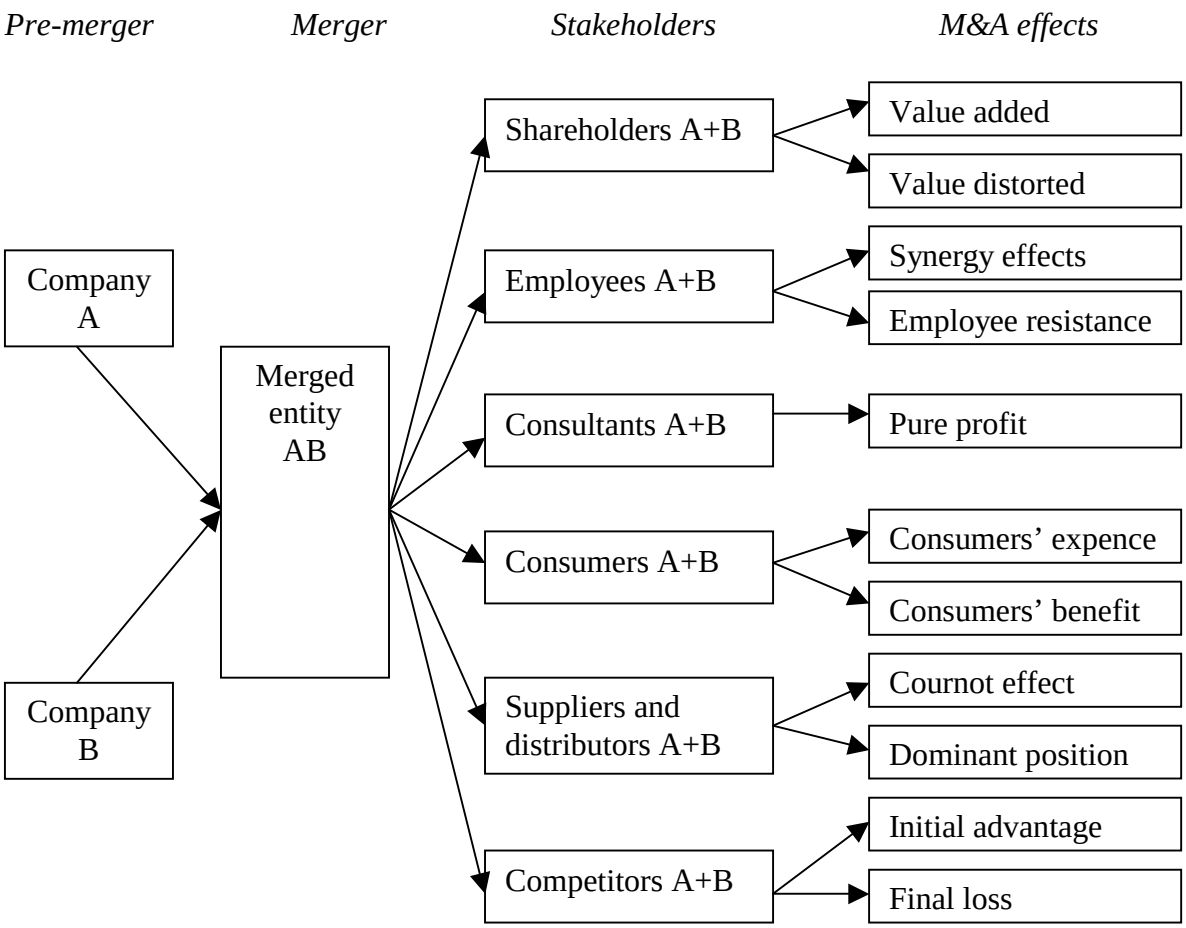
4. STAKEHOLDERS' IMPLICATIONS

M&A are among the most complex practices in the modern business environment. But many other aspects should be seriously considered as underlying sources of potential success. Merging people, cultures and businesses is a high-risk deal, which can only create beneficial effects if all involved operate as a team. However, varying interests of all parties involved can easily cause confusion. Therefore, studies have shown that it is particularly important to define precise goals, develop a structured action approach, appoint responsible persons to carry out the deal, and establish sound monitoring units.[70]

The following chapters will analyse M&A' influence on certain interest groups (Figure 4). Shareholders are concerned whether invested capital is managed in a way to create added value. Employees, both on managerial and operational levels, are most directly affected by wide-ranging restructuring that occurs during the integration phase. Although consultants' fees are not completely dependent on the outcome, it is in their interest to recommend the most efficient solutions. Apart from these groups, M&A can have an influence on other market participants, such as consumers, suppliers, distributors and competitors. Each party can exercise more or less significant influence over outcome, or they can try to adapt to the newly created situation. The next chapters will examine which opportunities and setbacks stakeholders usually experience during M&A. Cross-border M&A often involve some additional issues that have to be solved in order for organizational changes to generate the desired outcome. Different cultures across the Member States do not allow managers to rely on a unique solution; instead, adaptation is required straight from the outset.

[70] Deloitte & Touche (2000), Solving the Merger Mystery: Maximizing the payoff of Mergers and Acquisitions

Figure 4. M&A effects on stakeholders

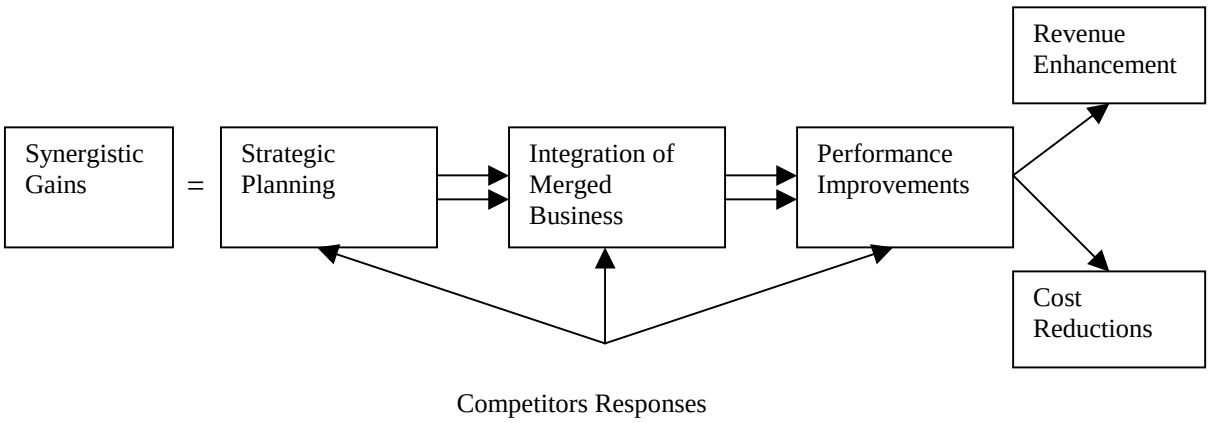


4.1. Shareholders

Shareholders' main consideration is to place the capital in a way that can generate the highest returns and sometimes M&A can be an optimal solution for achieving it. In principle, and according to portfolio theory, the combination adds little to shareholders if it is strictly for the purpose of diversification or expansion of sales because shareholders can achieve diversification or earnings expansion by buying shares of the two autonomous companies.[71] Therefore, M&A must produce synergistic gains in terms of enhanced revenue or cost reductions in order to raise shareholders' interest (Figure 5).[72]

[71] Petroff J. (2000): Merger and Acquisition Approach
[72] Gaughan, P.A. (2002), Mergers, Acquisitions, and Corporate Restructurings, p. 113: "Synergy refers to the type of reactions that occur when two substances or factors combine to produce a greater effect

Figure 5. The process of realizing synergistic gains



Source: Gaughan (2002)[73]

The significance of linking the whole M&A transaction was confirmed in 2002, when Deloitte published results of its extensive survey on companies engaged in M&A. The main founding was that transactions have a greater likelihood of success if companies created a structured process, documented their overall M&A strategy, articulated the strategy throughout the organization and M&A team, linked the strategy with activities such as due diligence and integration, monitored success and made adjustments to the strategy when necessary.[74] Nevertheless, in spite of all the theoretical suggestions for improvement, remarkably many companies go from initial enthusiasm to final disappointment. The most commonly cited causes of failure include target management attitudes and cultural differences (85%), little or no post-M&A planning (80%), lack of knowledge of industry or target (45%), poor management and poor management practices in the acquired company (45%) and little or no experience of acquisition (30%).[75]

Shareholders are aware of the fact that M&A destroy value in an alarmingly high proportion of cases. Therefore, they have become extremely cautious and now require close contact with the management. Once the shareholders become suspicious about the management's actions, this will immediately be reflected on the share price. A

together than that which the sum of the two operating independently could account for. Simply stated, synergy refers to the phenomenon of 2 + 2 = 5."

[73] Gaughan, P.A. (2002), Mergers, Acquisitions, and Corporate Restructurings, p. 120

[74] Dillavou, J. (2002), "The three questions to ask before buying a business"

[75] Arnold, G. (2002), Corporate Financial Management

distinction between different types of assets and transactions in the financial reports became a central point in evaluation. Single-time gains, unusual transactions and deviant market situations are no longer relied upon in forecasting future business trends. For example, if a company had an extreme increase of assets in a previous period, it is not enough to look into the internal operations. Instead, the whole macroeconomic environment must be analysed in order to detect if there have been any unusual changes in interest, currency exchange or inflation rates. Otherwise, a company, or more precisely its shareholders, might end up paying millions of Euros over the actual value of M&A.

4.2. Employees

Today's markets are characterised by the *heard behaviour*. CEOs are not extremely concerned about M&A failures once they notice that competitors are failing as well. This reduces the pressure and allows more risk-taking, but it can also lead to fiasco of irrationally ambitious plans. M&A are often designed to satisfy the top management's and main investors' needs, keeping other employees away from the decision-making process. In turn, this often causes considerable employee resistance. Some of the major reasons for bad employee performance after the integration are cultural clashes, vicious control and conflict circles, employee layoffs and voluntary exits, demoralization, merger syndromes, and corporate mourning.[76] It is a common observation that M&A restructuring is closely linked with downsizing. Although this is certainly not a desirable consequence, it can be partly justified by the macroeconomic perspective. Improving company competitiveness is the only effective way to ensure sufficient growth to create lasting jobs in the long run.[77]

M&A are likely to affect employees on all organisational levels in both of the merging companies. Although it might seem that managers have better negotiating power and therefore a better position in a new company, it is not always so. The managerial layoff is especially characteristic in hostile takeovers, where the top management experiences

[76] Larsson, R. (1990), Coordination of Action in Mergers and Acquisitions: Interpretive and Systems Approaches towards Synergy, p. 219
[77] European Commission (2000), Competition Policy in Europe and the Citizen

the highest career uncertainty. In roughly 90 per cent of the cases the directors of the boards of target companies are replaced within two years of the takeover.[78]

Although there are numerous strategic options that can be applied to M&A, many aspects vary across the cultures. The EU territory is not particularly large, but it comprises cultures of 25 Member States. Applying Hofstede's theory of the four cultural dimensions, many differences can be found.[79] For example, employees in Northern Europe do not appreciate high hierarchy structures in companies and they prefer to be involved and consulted about business decisions, including the ones about M&A. On the contrary, South European employees prefer to be told what they are supposed to do and not be pressured to make any decisions on their own. The same differences exist to other dimensions, with Nordic Member States being highly individualistic, feminine and with low uncertainty avoidance, and Southern Member States being more collectivistic, masculine and with higher uncertainty avoidance. This indicates that European employees do not expect to be treated in the same manner, emphasising the problems of dealing with employee resistance in cross-country M&A.

It can be concluded that the team, which is planning M&A, must employ individual approaches in attracting the most valuable employees, because people have different appraisal values. Otherwise, there is a risk that employees would become frustrated and eventually leave a company if their needs are not well satisfied.

4.3. Consultants

Since M&A can be extremely complex, it is crucial for companies to appoint a number of experts to carry out the procedure. Historically, investment banks, legal and accounting consultants were considered to have exclusive competence for the job. In the last five years, statistics reveal an increase using hiring in-house experts to deal with M&A (Figure 6). However, independent advisors repeatedly contest the strengths of such strategies, pointing out their more advantageous negotiation position due to a

[78] Mayer, C. (2000), Developing the rules for corporate governance", Mastering Management, p.6
[79] Hofstede's four dimensions: Individualism/Collectivism, Large/Small Power Distance, Strong/Weak Uncertainty avoidance and Masculinity/Femininity; Hofstede, G. (1984), Cultural Dimension in Management and Planning

broader overview of the market. On the other hand, companies are attracted by lower costs when using experienced in-house experts, who are typically very dedicated to the deal and the company.

Figure 6. M&A completed without external financial advisers,
(% of total value of transactions), 1999 - 2003

	1999	**2000**	**2001**	**2002**	**2003**
Italy	9,7	8,8	13,3	18,5	7,5
France	5,1	4,6	7,2	8,6	8,0
UK	4,7	5,7	8,0	9,9	13,4
Germany	2,9	7,7	6,9	13,0	18,3
Spain	13,5	11,0	22,4	22,6	20,1
EU average	7,6	8,4	11,2	12,6	14,0

Source: CFO Europe[80]

The costs of obtaining legal advice on operations with significant competition concerns may be between €75,000 and €150,000.[81] Apart from legal costs, companies also hire accounting experts and other specialists, whose fees rise proportionally with the size of the transaction. Vodafone's takeover of Mannesmann is an extreme example to describe the consultancy expenditures. In 2000, Mannesmann's management approved €200 million to be spent on employing four investment banks, four legal firms and a number of other consultants.[82] Vodafone's expenses were even higher, showing the company's determination to carry out the takeover. Considering that consultants are paid regardless of the M&A success, they are often the ones who profit the most.

4.4. Consumers

Companies often become preoccupied with procedural matters of M&A, forgetting the core intention of the transaction; that is to say, satisfying the customers. Acquiring a new company does not directly mean acquiring new customers. Moreover, existing ones might be lost too. Before a merger is announced, the companies act as competitors. The most loyal customers might oppose the idea to merge with 'an enemy' and obstruct further consumption of the merged company's products. In September 2001, Halifax

[80] "All by myself", CFO Europe, http://www.cfoeurope.com/displayStory.cfm/2261163, January 2004
[81] Broberg, M.P. (1998), The European Commission's Jurisdiction to Scrutinise Mergers, p.227
[82] Arnold, G. (2002), Corporate Financial Management

merged with the Bank of Scotland and HBOS was created. Even today, the integration of the two banks is not fully accomplished, leaving customers miserable. Due to the system transformation, there have been continuous delays and inconsistencies in handling the personal accounts. The biggest problem seems to be that many customers are not in favour of the merger whatsoever, considering it as a loss of influence for the Bank of Scotland.[83]

The loss of customers might be even greater in cross-border M&A due to patriotic feelings or cultural differences. Not that many Greeks would feel comfortable if the Olympic Airways would merge with a Turkish airline, despite its current liquidity troubles. Furthermore, some Member States enjoy bad reputation on specific product markets. For example, it is doubtful if French customers would be enthusiastic about a French company merging with a beef producer from the UK. Such considerations are important on markets with strong competition and where product substitutes exist.

4.5. Suppliers and distributors

A company has three basic options when it considers who to merge with and how to explore the potential benefits. It can decide to merge with its competitor (horizontal merger), supplier/distributor (vertical merger) or with a company that it does not share any market with (conglomerate merger). As discussed in chapter two, the decision will depend on the main goal of the merger. Each of the three options is capable of generating specific advantages, provided that it well matches the basic strategy of both companies involved.

There is an ongoing debate to what extent concentrations on different distributional levels, but on the same product market, can be harmful to competition. Some scholars argue that vertical mergers can reduce prices as a result of the *Cournot effect*: a merger of two firms that produce complements, in which at least one firm has market power, will generally result in the combined firms lowering the prices of one or both goods,

[83] "Transfer Trouble" in BBC News 26/04/2004; and "HBOS boss apologises to customers", in BBC News 13/01/2004

and thereby benefiting consumers.[84] On the other hand, companies can gain greater power by establishing mutual links, which may possibly strengthen their dominant position and in the long run harm competition. The US courts are not especially concerned about this potentially negative outcome, whereas the EU Commission gives more attention to the matter.

4.6. Competitors

A merger between companies that operate on the same market level, usually competitors, is referred to as a horizontal merger. This type of merger is the most common one, but it represents a potential problem: eliminating or reducing the competition, or in extreme cases creating a monopoly. When two former competitors decide to merge, customers' choice can easily become limited. On the other hand, it can be argued that larger concentrations would have more available resources for research and development, which could ultimately produce even more choices and higher quality of offered products.

Moreover, companies are especially vulnerable in the initial phase of M&A. If the remaining market competitors can take an advantage of such weaknesses, they could do much harm to the merging companies before they begin to function as one unit. While the merging companies are concerned with the integration process, competitors are focused on winning over their customers. However, once the merger is carried out, it is expected that the merged companies would regain lost market power and hopefully increase it.

[84] Evans, D.S. & Padilla, A.J. (2003), Demand-side Efficiencies in Merger Control, World Competition 26(2): 167–193, 2003, Kluwer Law International, Netherlands

5. COMPETITION, COMPETITORS OR CONSUMERS?

Having examined the rationale of M&A, legal implications and stakeholders' interests, it is now time to conclude whether the EU can benefit from M&A and the merger control. Throughout the previous chapters it has been shown that numerous competition issues are still unresolved, creating debates and accusations between conflicted parties. However, the Merger Regulation appears to be well appreciated among companies with large-scale operations on the EU market.[85] Before examining who is better protected by the Regulation, it will be discussed whether M&A has proven to be a good choice for companies or if they are only ambitious plans in theory.

5.1. M&A – value creators or value distorters?

According to global business reports, there was a growing trend in M&A activity until 2000, followed by a slowdown ever since. With the generally perceived view that only one fourth of all M&A actually managed to create value, it becomes understandable why companies instead have come to explore other solutions. However, more recent studies show that the failure of 75% is only a true number if we count it as the proportion of total wealth destruction, but not if we count the proportion of unsuccessful M&A in the total number of cases. "The wealth destruction was concentrated among the biggest deals. During the period from 1998 to 2001, some 87 deals – just over 2% of the total – each destroyed over $1 billion of acquiring-shareholder wealth. By contrast, the remaining deals on average created wealth for both sellers and buyers."[86] From another perspective, flourishing stock markets in 1990's made M&A much more attractive since it was possible to acquire other companies relatively cheap, by paying for them with overvalued shares. It must be noted that high failure rates of M&A in the end of 1990's correspond to the instability of the global markets. Therefore, the distortion of immense

[85] "The Regulation is now one of the European Commission's most highly praised legal instruments. A number of explanations have been put forward in order to justify this popularity. Cost efficiency and speediness are the most common publicly aired reasons. Unofficially, however, the claim that the European Commission is more sympathetic towards concentrations than are the national competition authorities is widely held to be the real reason." in Broberg, M.P. (1998), The European Commission's Jurisdiction to Scrutinise Mergers, p.195

[86] "Mergers and acquisitions: When battles commence", The Economist, 21/02/2004, p. 66

value, which M&A took the blame for, might have had happened anyway due to bursts of equity bubbles and stock market crashes.

5.2. All because of whom?

The main aim of the competition policy integrated in the Merger Regulation 4064/89/EEC is to "ensure that competition in the common market is not distorted."[87] The starting point in evaluating the significance of competition can be found in economic theory. According to it, a key advantage of free market competition lies in preserving low prices. Considering the *demand elasticity*, companies do not attempt to increase the prices much above their competitors.[88] Under the assumption that consumers are well informed about the market supply, they would be expected to switch to a cheaper substitute when available. There are factors that can slightly influence consumer behaviour, like loyalty or brand image, but only within a relatively narrow range. All of this is only possible in a situation of free market competition where consumers have a freedom of choice. Moreover, companies operating in competitive environment are more concerned about keeping and attracting customers, and are therefore more likely to invest in product development and service improvement.

As a result of the above considerations, it can be argued that both competitors and consumers should be protected in order to preserve the competition. However, the US International Competition Policy Advisory Committee noted in its report in 2000 that "nations should recognize that the interests of the competitors to the merging parties are not necessarily aligned with consumer interests."[89] According to the same source, competitors may oppose a merger precisely because it would create a more efficient firm, one that will aggressively serve customers better than the existing industry configuration. The reasoning in the sole favour of consumers is obviously accepted in the US, but it would be much harder to present it to the EU Commission. In the last

[87] Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings, Preamble (1)

[88] The Harper Collins Dictionary of Economics (1991): "Elasticity of demand is a measure of the responsiveness of demand to changes in price. It is the ratio of the percentage change in quantity demanded to the percentage change in price over a price range.", p. 162

[89] Economic Report of the President and the Annual Report of the Council of Economic Advisors (2002), p. 128

fourteen years, a number of M&A cases pointed out that "the Commission would not treat efficiencies as a defence to a merger that created or strengthened a dominant position, and that it might even view efficiencies as an additional reason for prohibiting a merger on the ground that they would further entrench the merged firm's dominant position."[90]

Frequent debates between the EU and the US authorities point out the necessity to coordinate competition policies. Both systems employ rather similar principles in handling the cases in this area, but the interpretation of legal texts differs. It is often argued that the US aims to protect the competition, whereas the EU is more concerned about competitors.[91] This most probably originates from the different cultures of the two markets. The US market is business oriented with an emphasis on the *laissez-faire* doctrine that stands for free trade and free competition.[92] On the other hand, the EU market is built on values other than pure economic prosperity, aiming to ensure proportionality, equality, quality of life etc. As highlighted in the GE/Honeywell merger, discussed in chapter 3.3, this inconsistency has caused problems in the past.

As shown above, companies have several motives for M&A, but only rarely do they acknowledge the main reason; acquiring more consumers. Often based on wrong assumptions, marketing research has underestimated this field. Companies take it for granted that customers of the merged company will be exactly the ones who were customers of the two individual companies. This is hardly ever so. Restructuring does not only affect the two companies, but it also initiates broad market response. Due to lack of concern in this area and insufficient planning, consumers might feel neglected and switch to competitors. However, where the process is well organised and companies do not lose their focus from customers, they are capable of enjoying synergy effects. A bigger and stronger company with a broader product line can certainly be an attractive market participant.

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[90] Gotts, I. & Goldman, C.S. (2003), "The Role of Efficiencies in M&A Global Antitrust Review: Still in Flux?", p. 220

[91] Fox, E.M. (2003), "We protect competition, you protect competitors", p.1; also
Akbar J. (2002), Grabbing Victory from the Jaws of Defeat: Can the GE/Honeywell Merger Facilitate International Antitrust Policy Co-operation?, p. 13

[92] The Harper Collins Dictionary of Economics (1991): "The implications of this theory is that private enterprise, competitive markets for factors and products, and unimpeded international commerce will lead to optimum consumer welfare and a rising standard of living.", p. 294

6. FINAL REMARKS

Mergers and acquisitions can provide an attractive business solution, but it is very hard to satisfy every need. As explained above, it is sometimes more suitable to form a joint venture, or even develop internally. Obviously, each type of concentration can offer certain advantages and therefore it is extremely important to clearly define the intentions and expectations. However, due to their extensiveness, cross-border M&A can often satisfy a wide range of company needs, primarily because they offer fast growth, which is essential on the global markets.

The EU has a fairly efficient M&A legislation, which is constantly evolving in a way to better serve the people of Europe. The Merger Regulation 4064/89/EEC is appraised as beneficial to competitors, consumers and the whole EU market. It has left some issues uncovered, but the Commission is trying to fulfil such holes by employing principles that have developed through case law. Moreover, the new Merger Regulation 139/2004/EC is expected to contribute even further to market transparency. There are differences between the EU and the US legal system, but assessing which is more appropriate is beyond the purpose of this essay. Today's markets are demanding high efficiency, which is acknowledged in the M&A legal mechanisms, leading to clearer division of powers between the EU bodies and the Member States.

Under scrutiny of the Merger Regulation, cross-border M&A have the power to influence the whole relative market. Each party affected reacts in a different way, making it complex to determine whose interests should be satisfied. However, from the case law it is apparent that the merger control is aimed to protect the consumers. Also, from the business perspective, the ultimate goal for the companies involved is to acquire more consumers. Therefore, it can be argued that M&A represent an important business choice for the companies, which may be carried out as long as they are conducted in a way to preserve the competition. The European Union acknowledges these values, and with a sufficiently regulated market, it also well prepared for the future.

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