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Master thesis

International corporate governance in cross-border M&A, a new integrated framework from empirical studies

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Abstract

Master thesis of Business Administration in Corporate and Financial Management

Title: International corporate governance in cross-border M&A, a new integrated framework from empirical studies

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Purpose: The aim of this thesis is to construct a theoretical framework about corporate governance problems and how they might be solved in conjunction with cross-border Mergers and Acquisitions.

Method: By combining both theoretical materials and practical investigations, we have primarily chosen qualitative research methods by demonstrating 5 cases study in total, rather than the traditional quantitative research methods.

Conclusion: Successful multinational M&A are not easy, there are many factors needed to consider for participants in cross-border M&A transactions. In addition to traditional corporate governance factors, which mainly embody board of directors, managers and stakeholders and so on, some other factors such as country norms and value, government legislation and regulation, public pressure and media are also vital important for conducting a prosperous cross-border M&A business. Given the recent M&A failures, a further research on this aspect of corporate governance could be helpful.

Acknowledgements

This master is the most challenging project we have done during our studies in School of Economics and Management, Lund University. This paper includes both corporate restructuring and corporate governance. As a major activity in corporate restructuring, cross-border merger and acquisition is a main study subject in our master year. We have also studied corporate governance through out the whole project, which is not familiar to us. Although we have been hectic during the two months, we believe the time has been well spent.

We would like to thank Mr. Claes Svensson who provide us with comprehensive theoretical resources and structure which our conceptual framework is based upon. Especially, on the day in hospital where everybody has rest and peace, he has not stopped helping us with our thesis. Without his efforts and supports this thesis will never be accomplished.

Sincerely

Shaohua Wang
Yan Liang

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Chapter 1 Introduction

1.1 Background

Beijing Huiyuan Beverage and Food Group Co., Ltd. was founded in 1992. It is a large and modern group company engaged in producing and marketing fruit and vegetable juice and juice drinks. Huiyuan's juice concentrates, purees and juice products have been exported to over 30 countries and regions, including USA, Japan, and Australia and so on[1]. Actually, in China Huiyuan Juice is absolutely in a competent leading position.

However, on 3rd September, 2008, it is announced that The Coca-Cola Company intended to purchase Huiyuan Juice. The news drew a lot of attention from not only the nation but also the overseas. Subsequently, after experiencing the investigation from the Chinese Ministry of Commerce and the negotiation between the two parties, on March 18, 2009, the CMC rejected Coca-Cola's (KO.N) $2.4 billion bid for China's top juice maker, Huiyuan Juice.

The Coca-Cola and Huiyuan deal is kind of similar with some merger cases happened during the recent merger wave, for example, Vodafone-Mannesmann[2], Daimler and Chrysler, Pepsi-Danone and other M&A activities initiated by Danone in China. Although Coca-Cola purchase of China's Huiyuan failed in the first phase, there are still some factors and reasons in common behind these M&A transactions, in addition to the grievous shock to corporate culture arose from these cross-border Mergers and Acquisitions (M&A).

Different corporate governance systems play a significant role in this kind of

[1] Introduction of Huiyuan Group Homepage: http://www.huiyuan.com.cn/en/about/

[2] the takeover of the Germany engineering and telecommunications multinational Mannesmann AG by the British-based Vodafone Airtouch Plc. in 2000. These cases will be described and studied in the following of the thesis.

cross-border M&A deals, the interests of stakeholders involved into the business are an indispensable element needed to be taken into account. Today, there is a growing dialogue among the different stakeholders about corporate governance and how it should evolve to cope with the increasingly dynamic and global nature of capital markets. This dialogue is taking place against a background of legislative and regulatory change; the implementation of International Financial Reporting Standards around much of the world; an increase in the scope of audit and other internal control and risk management activities; and increased public scrutiny[3]. Good corporate governance is a key to the integration of corporations, financial institutions and markets, and central to the health of our economies and their stability.

Although corporate governance rules and usages are not generally associated with M&A, they apply in these special situations and with exceptional force. There are almost no specific corporate rules for M&A except new laws, enacted or pending, relating to public companies mainly in tender offer and similar stock exchange situations, often prompted or influenced by EU Law[4]. So far, through imitating and referring to EU Law, more and more countries have issued relevant law and regulation covering anti-monopoly, accounting, financial statement, auditing, remuneration etc. Around 1200 large companies in China have diversified their ownership through public listing[5]. Accompanying this process, in 2002, Chinese code of corporate governance was published by the China Securities Regulatory Commission; the code is applicable to listed companies including Huiyuan Juice which was published on the main Board of the Hong Kong Stock Exchange in 2007[6].

Afterwards, the Anti-monopoly Law of the People's Republic of China, which was adopted at the 29th meeting of the Standing Committee of the Tenth National People's

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[3] Corporate Governance: encourageing dialogue and participation
http://www.ey.com/global/content.nsf/International/Corporate_Governance_-_overview

[4] Reinhard Pöllath etc., corporate governance in M&A situations: focus on Germany See the article which can get from http://www.pplaw.de/_downloads/publications/2005/RP-2005-Corporate-governance.pdf

[5] Clarke Thomas (2007), International Corporate Governanace, Routledge. See page 216.

[6] "Our History on Huiyuan's" Homepage http://www.huiyuan.com.cn/en/about/develop.html

Congress of the People's Republic of China on 30th August, 2007, was enacted to be effective as of 1st August, 2008[7]. Practically, the acquisition of Huiyuan was the first major deal to test China's new anti-monopoly law. We have to say that, the regulation of different countries is increasing its own power to influence the process and results of international M&A.

1.2 Problems

Since the available evidence does not provide the final result and conclusion of the event between Huiyuan and Coca-Cola merger, in this thesis, *firstly we will seek to investigate the reasons behind these M&A cases of the recent merger period mainly from corporate governance perspective and the relevant factors which influence the business form.* Special attention is given to corporate governance which generally can be described as the relationship among various corporate participants in deciding the direction and performance of companies. Take Vodafone-Mannesmann case as an example, as Hooper and Gow mentioned, "The Mannesmann takeover demonstrated a profound inertia and deep resistance in Germany towards the global trend of emphasizing the importance of shareholder value above all corporate objectives.[8]" Owning to the conflicts with equity market based Anglo-American model, there finds some problems in German corporate governance system which eventually resulted in the demise of control right of Mannesmann, which was once considered as a great and successful company in Germany.

Then, given the similarity with the four M&A examples[9], we will discuss how China Huiyuan Juice Group is governed and managed, thus to exam the role of corporate governance in Coca-Cola and Huiyuan event. In China, shareholders are considered

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[7] Order of the President of the People's Republic of China(No.68)
http://www.lawinfochina.com/law/display.asp?db=1&id=6351

[8] Clarke Thomas (2007), International Corporate Governanace, Routledge. See page 413.

[9] Vodafone-Mannesmann, Daimler and Chrysler, Pepsi-Danone and other M&A activities initiated by Danone in China.

as the source of power which is enjoyed by board of directors, rather than the legislature. This corporate governance philosophy resembles the political governance philosophy expressed by the Chinese constitution[10]. Huiyuan is the first major deal which was rejected because of not passing Chinese anti-monopoly law. *The problem how the Chinese government/regulations influence the corporate boards in China will be discussed in this paper.*

Given the Chinese special developing circumstance, the development of corporate governance in China must be subject to effects and restrictions of institutional circumstances and the traditional planning economy model. On the other hand, the transition of corporate governance in China is an artificial and mutation process but not a natural transition process with the development of modern corporations[11]. *Accordingly, in our study, we seek to establish a conceptual framework from corporate governance perspectives,* particularly in the course of the current transition stage and reform process for China. As a matter of fact, Chinese companies are facing a great challenge to move from a relationship-based to a ruled-based system of corporate governance, abandoning the bond of traditional and political relationships, and replacing these with the impersonal rules of governance and institutions[12].

1.3 Purpose

When we consider several of the major merger failures of recent years, we see that a common theme they share is poor corporate governance. Patrick A. Gaughan indicates that classic failed mergers between WorldCom and MCI, Daimler and Chrysler, and AOL with Time Warner merger were result from weak corporate governance which needs to be vigilant in monitoring management strategy and merger and acquisition

[10] Gang Wei and Mingzhai Geng, ownership structure and corporate governance in China, the article is available at www.emeraldinsight.com/0307-4358.htm

[11] Ibid

[12] Clarke Thomas (2007), International Corporate Governanace, Routledge. See page 217

plans.[13] Furthermore, even successful cross-border merger, Vodafone-Mannesmann merger for instance, had also met conflicts between different corporate governance systems; which played a key role in the Anglo-American's challenging of the German capitalism structure.

In this paper, by beginning with demonstrating the analysis of 4 cross-border M&A, we aim to construct a theoretical framework about CG problems and how they might be solved in conjunction with cross-border M&A.

Traditional corporate governance emphasized on the conflicts of interest between managers and owners. The controversy in corporate governance nowadays has been driven much attention on the increasingly recognized conflicts of the interests occur across a wide range of stakeholders: owners with large ownership positions, other owners with small number of shares, managers, creditors, partners, employees, consumers, competitors, governments as well as the society. In addition, among the more contextual and industrial variables that influence the business form and system of corporate governance adopted are[14] national regional and cultural differences, Ownership structure and dispersion, the industry and market environment of corporation, firm size and structure, lifecycle variations, including origin and development, technology, and periodic crises and new directions, CEO tenure, attributes and background. Thus, we believe that an integrated framework of corporate governance is eagerly to be defined in activities of cross-border M&A.

We will also test each items in this framework by taking a "on progress" cross-border M&A in China Coca-cola and Huiyuan, and provide supplements with new findings.

In recent decades, more and more investors or firms focus growth via cross-border M&A activities. China, whom the "the country of future" calls after, has appeal

[13] Patrick A. Gaughan, Failed Merger: Failed Corporate Governance?, 2005 Wiley Periodicals,Inc.
[14] Huse 2005:68

hundreds of foreign investors for its potential in growing economy, market demand and cheap labor costs. However, as differences among corporate governance systems and sovereign issues so forth, many activities have proved that making business in China is not as easy as investors could have realized. Despite synergies generated by mergers might be great for acquirer and the target, the corporate governance systems adopted by both and all stakeholders involved are hardly to be neglected.

Finally, we will re-fine the frame work by new findings from Coca-cola and Huiyuan merger, to ensure a comprehensive corporate governance framework for firms who are interested in or currently working on M&A activities. Besides that, we will also provide evidences and resource for further study in this area.

1.4 Delimitations

The M&A literatures are extensive, covering various aspects of the topic. However, in our thesis, we focus on the aspect of corporate governance. Six contextual and industrial variables mentioned in Clarke Thomas (2007)'s book are vital important to influencing the business form and system of corporate governance adopted, consequently we chose several of them which are related to cross-border M&A for discussion and analysis, for example, national, regional and cultural differences, CEO attributes and tenure.

As mentioned in the previous chapter, the framework we intend to build up for firms who are interested in or currently working on cross-border M&A, should be based on more research into previous study results possibly in the form of research papers, articles and so on. Since numerous books and research papers are found about cross-border M&A, it is not possible to refer to all the previous study papers, articles etc, we limit into some of them which is more representative and related. Indeed, there are a lot of cross-border M&A issues happened in the world, considering our

time and effort limitation, we just focus on studying four cross-border M &A cases: Vodafone-Mannesmann, Daimler and Chrysler, Pepsi-Danone and other M&A activities initiated by Danone in China. There are two major reasons about why we choose these four cases; firstly, all of them are international and cross-border which covered five different countries in the world-England, USA, Germany, France and China. Secondly, the four M&A are representative which are often cited as case study in many papers and researches. Some of them failed, some succeeded, but behind these there are different reasons on corporate governance aspect.

Given Chinese particular business environment, corporate information is not so transparent and open as the western countries. In the thesis, when we use our framework to test in Coca-Cola and Huiyuan case, sometimes as a result of this information mechanism limitation, we can not get certain information on some problems, thereby we choose to apply a hypothesis approach to discuss and analyze.

1.5 Outline

This master thesis is consisted of 9 chapters which begin with a research background and intentions briefly presenting the contents of the study. And the continuing chapters present comprehensive analysis as follows:

Chapter 2 Methodology

This chapter presents the motivation of the chosen subjects. The intention of adopting a qualitative research instead of the traditional quantitative research methods is explained. Validity and reliability of this thesis is also discuss in this chapter

Chapter 3 Hostile Merger and Acquisition and cross-border conditions

This chapter aims to explain the theories of cross-border hostile merger. In addition, contextual and industrial variables that influence the business form are

demonstrated in this chapter as well.

Chapter 4 Theory of Corporate Governance

In this chapter, we will list corporate governance theories and concepts that build up the foundation of this thesis. It provides an insight of international corporate systems, as well as presents a convergence of contextual variables within the system of corporate governance.

Chapter 5 Empirical cases studies

This chapter presents the empirical findings from 4 cross-border M&A cases, including background information, conflict description, consequences, analysis and evaluation for each.

Chapter 6 A corporate governance framework for cross-border M&A

Summarizing 4 cross-border M&A cases study in previous sections; in this chapter, we construct a corporate governance frame work which covers fundamental theories in Chapter 4 and the evidences from the 4 cases in Chapter5.

Chapter 7 Empirical test of framework

This chapter will test and provide new evidence or findings by a “on-progress” M&A in China, Beijing Huiyuan Beverage and Food Group Co. and Coca-cola company, in order to refine the framework produced in Chapter 6 to accomplish our study.

Chapter 8 A refined conceptual corporate governance framework in cross-border M&A

Following the analysis of Coca-Cola and Huiyuan’s analyzed by the conceptual framework of Chapter 6; we have five new findings of corporate governance problems besides the issues in the framework. To refine this conceptual

framework, these five new findings will be supplemented.

Chapter 9 Conclusion

This chapter will discuss further in regards of the challenges of international corporate governance in cross-border M&A. Final conclusion will provide a restructured framework on international corporate governance in cross-border M&A, and outline some suggestions for possible further study.

Chapter 2 Methodology

2.1 Choice of subject

The globalization of business via M&A over the past decades has spawned a search for competitive advantage that is worldwide in scale.[15] Despite of this international growth strategy, shareholders of both parties focus on gaining at rich premium on share price from synergies. However, according to the results of a major new study from global management consultancy Hay Group, more than 90% of corporate mergers and acquisitions are falling short of their objectives, as companies struggle to combine corporate cultures and structures.[16] By having studied both corporate restructuring, financial risk management and corporate governance in university educations, as well as our personal background, our study of this thesis lays in the fields of cross-border corporate restructuring and corporate governance.

2.2 Build up a framework

A literal meaning explains, a framework is a real or conceptual structure intended to

[15] Finklestein, Sydney. Financial Times Mastering Global Business: The Complete MBA Companion in Global Business, London: Financial Times Pitman Publishing. Finkelstein, S. 1999. "Safe ways to cross the merger minefield." p. 119-123.
[16] 91% of company mergers fail to deliver, Hay Group press, LONDON, United Kingdom, 26 March 2007. http://www.haygroup.com/cn/Press/Details.aspx?ID=10178

serve as a support or guide for the building of something that advances the structure. A good framework is not a principle that simply provide rationale and legal terms when implement an activity. In contrast, it should also educate the users the correct and efficient way that help them to achieve their objectives, and produce more possibilities for users to approach each component in framework.

According to James McRitchie (1999), "the corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society"[17] Besides of that, corporate governance framework also depends on the legal, regulatory, institutional and ethical environment of the community.[18]

In this thesis, we present four cross-border M&A cases study. We primarily analyze each case by investigating the reasons and corporate governance problems behind each story. Based on the findings, we will draw a corporate governance framework in Chapter 6 with intention to serve those firms who hold intentions to implement foreign direct investment in M&A expansions. Moreover we will refine the framework in Chapter 8 by new findings from Coca-cola and Huiyuan merger in Chapter 7, to ensure this framework comprehensive.

2.3 Theoretical framework

At the beginning of this chapter, theories and concepts are applied and reviewed in Chapter 3 and Chapter 4. Thereafter, the role of selected components in corporate governance and cross-border M&A theories are concretized and discussed. We will apply those theories in this thesis placed on five chosen cases in Chapter 5 and Chapter 7. The convergence theory including new findings will serve as a framework as the outcome of case studies.

[17] Adrian Cadbury. 'Global Corporate Governance Forum', World Bank, 2000
[18] James McRitchie, 8/1999

2.3.1 Corporate governance theories

CG Definition

Corporate governance is one of the most talked about topics in business, indeed in society, today. Considering that issues of executive compensation, financial scandals, and shareholder activism are all tied up with corporate governance. There are different definitions on corporate governance from different views.

The OECD in its *1999 Principles of Corporate Governance* elaborated the definition by referring to corporate governance structures and objectives[19]:

Corporate governance is the system by which business corporation are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.

Good corporate governance is a key to the integrity of corporations, financial institutions and markets, and central to the health of our economies and their stability[20]. As Alba Joseph D. et al [21]described that, a stronger corporate governance environment will reduce the opportunities for improving corporate performance and increasing shareholder value. This will reduce the demands for M&A activities, including cross-border M&A activities such as the acquisition of US firms by Japanese firms.

[19] Clarke Thomas(2007), pg2
[20] http://www.oecd.org/topic/0,3373,en_2649_37439_1_1_1_1_37439,00.html 2009-5-18
[21] Alba Joseph D. et al, " Corporate governance and merger and acquisition (M&A) FDI: Firm-level evidence from Japanese FDI into the US", Journal of Multinational Financial Management; 19(2009)1-11.

Four well-known approaches in corporate governance field

Corporate Governance is a relatively new area for the public, and came into a large focus in the beginning of the 90s in Europe, although the development from corporate governance can be tracked long before that. This while it rests on old theories, first and foremost the agency theory, the stewardship theory, the transaction cost economics and the stakeholder theory. In chapter 4, we will outline and explain these four theories in order to generally understand and review corporate governance.

Diversity in corporate governance

Different traditions, values and objectives will undoubtedly produce different outcomes in governance, which will relate closely to the choices and preferences people exercise in business activity[22]. Different approaches to business formation and the accompanying corporate governance structures and regulations have evolved in different social and economic contexts[23]. Among the more important contextual and industrial variables that influence the business form and system of corporate governance adopted are:

- National, regional and cultural differences;
- Ownership structure and dispersion;
- The industry and market environment of the corporation;
- Firm size and structure;
- Lifecycle variations, including origin and development, technology, and periodic crises and new directions;
- CEO tenure attributes and background.

We will select several of these six dimensions to study as our theoretical base when building a framework from corporate governance perspectives, for those who are interested in or currently working on M&A activities. Meanwhile, we also refer to

[22] Clarke Thomas (2007), pg262.
[23] Clarke Thomas (2007), pg9.

several of these six aspects during analyzing and studying the four empirical cases in chapter 5.

2.3.2 M&A theories

M&A theories are the fundamental framework for cross-border M&A analysis. In chapter 3, we will cover the concepts of M&A, the competitiveness theory explaining motive of M&A, and value creation theory presenting drivers of M&A strategies.

Concepts of M&A

Studying previous literatures, we acknowledged that when one company takes over another and clearly established itself as the new owner, the purchase is called an acquisition. The target company ceases to exist, the buyer acquires the business and the buyer's stock continues to be traded. On the other hand, a merger happens when two firms, agree to go forward as a single new company rather than remain separately owned and operated, which is more precisely referred to as a "merger of equals." Both companies' stocks are surrendered and new company stock is issued in its place. However, Gaughan pointed out that in the merger and acquisition field, many of the terms are sometimes used interchangeably; the distinction is often blurred in practice. Giving the motivations in Chapter 3, we will not distinguish merger from acquisition in this thesis.

Competitiveness theory

Competitiveness is the key driver behind M&A, and many literatures have already indicated that multinational corporations have been seeking for M&A to enhance their competitive advantage. Corporations are stimulated by this and construct M&A strategies in order to achieve corporate objectives. Therefore in Chapter 3 we will explain how competitiveness functions in cross-border M&A.

Convergency theories of value creation

According to Gaughan, Patrick A. proponents of M&A will often point to an ability to grow faster and anticipated synergy as the justification for a successful deal. In this thesis; we will use synergies, increased market power, control of penetration as key objectives that maximize the wealth of the shareholders of corporation.[24]

Gaughan, Patrick A. indicates that synergy is the potential additional value from combining two firms which is translated into the ability of a corporate combination to be more profitable than the individual parts of the firms that were combined, and the major objective that corporation would like to achieve in M&A.

Market power, which is sometimes also referred to as monopoly power, is defined as the ability to set and maintain price above competitive levels.[25] And there are three sources of market power: product differentiation, barriers to entry and market share.

- **Product differentiation** can be achieved by extending product line or international coverage, and integrated R&D and innovation technology.
- The lack of significant product differentiation or **barriers to entry** could prevent a firm from being able to raise its price significantly above marginal cost.
- Through horizontal integration, a company is able to increase its **market share**.

Control of penetration is applied from a macro-economics perspective in this thesis. As industries that have become more concentrated, M&A will create a substantial amount of competition that reinforces corporations to further penetrate the market. Both suppliers and customers would prefer non-decreased value in changes. In compliance with this theory, we will discuss in Chapter 3 the magnitude of maintaining the interests and benefits of host country's suppliers and buyers, and the significance in building up their confidence in cross-border M&A.

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[24] Gaughan Patrick A. (2007),Mergers, Acauqisitions and Corporate Restrcuturings, Wiley, 4th, Page117
[25] Gaughan Patrick A. (2007),Mergers, Acauqisitions and Corporate Restrcuturings, Wiley, 4th, Page 146

2.4 Analysis methods

By combining both theoretical materials and practical investigations, we have primarily chosen qualitative research methods by demonstrating 5 cases study in total, rather than the traditional quantitative research methods. Although quantitative uses statistics and replicability to validate generalization, it has difficulties to respond to uncontrolled variables in specific situations. On the other hand, qualitative research has the resource in gradual response to the nature of the social setting being investigated as its nature is revealed.[26]

In addition, due to the occurrence time of the 4 mergers analyzed in Chapter 5 and the location difference between the authors and the study country-China in Chapter 7, secondary data are employed for both case studies. In addition, the availability of background information of the 4 mergers analyzed in Chapter 5 is provided in current publications, which helped us to retain a very time consuming method.

In contrast, the availability of information on Chinese corporate governance, and Chinese firms 'public financial reports are comparably short and limited. Considering those facts, we employ secondary data collected from validated institutions publications or concerned official websites etc.

2.5 Choice of cases

We have chosen 4 cross-border M&A cases study, some of the cases were failed of poor corporate governance; while others were successful in challenging another corporate governance system. We use previous evidences from current empirical research and literatures to ensure a conceptual framework produced. Coca-Cola and Huiyuan merger study was primarily selected from a piece of recent financial news in China. After reviewing the merger progress and related articles from the press, we

[26] Holliday, Adrian; Doing and writing qualitative research; SAGE published, 2002

found that the rationale behind the first failed attempt made by Coca-Cola is fairly identical to the arguments in international corporate governance. And the most important, we employ "on progress" case study to evaluate the traditional cross-border corporate governance. Furthermore, we also apply this case to test the framework we retrieved from previous empirical research, to construct a new corporate governance framework for cross-border M&A.

Although firms involved in our cases study are dispersed in different nationalities or industries, all obstacles that acquirers met after announcements embodied corporate governance issues that significantly influenced the progress of cross-border M&A.

2.6 Comparative analysis

This thesis is based upon empirical cases study in areas of M&A, corporate governance and contextual and industrial variables that influence the business form and system of corporate governance. The nature of hostile M&A is explained in each, and its influence on all stakeholders. Since all cases in this thesis involved three major corporate governance systems, each system is discussed and specified in cases. We will also employ contextual and industrial variables into each case to exam the degree of their influence on cross-border M&A, and what the consequences each case could have had.

2.7 Validity and Reliability

2.7.1 Validity

When conducting research, an important question is if the material collected is valid, i.e. if the applied "measurement instrument" really does measure what is relevant.[27]

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[27] Nyberg M.& Pettersson, "Institutional Investors-Ethical Criteria and Enforcement Practices", the thesis is available at http://theses.lub.lu.se/undergrad/search.tkl?field_query1=pubid&query1=FEK-00011631&recordformat=display

Validity concerns the relationship between the theoretical reference of the underlying problem and the operation of the variables to be analyzed in the process of collecting data[28]. In this study, secondary data is used which is collected from previous research papers, articles etc. We will select some of these previous study results, which are related to our study field and purpose. In fact, these previous studies were related to the underlying theory and have been ensured valid by researchers when doing these relevant studies. This approach ensures a high validity.

2.7.2 Reliability

Reliability indicates how reliable the various sources are. A high degree of reliability will ensure that our data is reliable and that is could facilitate the research by illuminating the problem. It is a concept that is more important when conducting quantitative research, than when conducting qualitative ditto.

Chapter 3 Hostile Merger and Acquisition and cross-border conditions

3.1 M&A Definition

According to Gaughan (2007)[29], a merger is a combination of two corporations in which only one corporation survives and the merged corporation goes out of existence. When the two firms differ significantly by size, merger is more appropriate than the term consolidation. From Gaughan's point of view, in the merger and acquisition field, many of the terms are sometimes used interchangeably; the distinction is often blurred in practice. Gaughan used the term "M&A" in the same breath, even did not intend to distinguish merger from acquisition.

[28] Ibid.
[29] Gaughan (2007), "Mergers, Acauqisitions and Corporate Restrcuturings", John Wiley & Sons, Inc. see page 12.

3.2 Defining Friendly and hostile M&A

The legal requirements governing M&A differ regarding whether a transaction is a friendly deal or a hostile deal. Among each of these categories, the rules also vary depending upon whether the transactions are cash or stock financed. The regulatory framework defines each of these alternatives as follows:

- **Friendly merger**—cash financed. The bidder is required to file a proxy statement with the Securities and Exchange Commission (SEC) that describes the deal. Usually, the bidder has to file a preliminary statement first. If the SEC makes comments, the preliminary statement may be changed before it is finalized. The finalized proxy statement is then mailed to shareholders along with a proxy card that they fill out and return. Following this, the deal has to be approved at a shareholders' meeting, whereupon the deal can then be closed.
- **Friendly merger**—stock financed. This process is similar to a cash-financed merger except that the securities used to purchase target shares have to be registered. The bidder does this by filing a registration statement. Once this is approved, the combined registration/proxy statement can be sent to shareholders.
- **Hostile deal**—cash tender offer. The bidder initiates the tender offer by disseminating tender offer materials to target shareholders. Such offers have to be made pursuant to the requirements of the Williams Act. This law is discussed at length in this chapter. However, unlike the friendly transactions described above, the SEC does not have an opportunity to comment on the materials that are sent to shareholders prior to their dissemination. The SEC may do so, however, during the minimum offer period, which will be described later in this chapter.
- **Hostile deal**—stock tender offer. The bidder first needs to submit a registration statement and wait until it is declared effective prior to submitting tender offer materials to shareholders. The SEC may have comments on the preliminary registration statement that have to be resolved before the statement can be considered effective. Once this was done, the process would proceed similar to a cash tender

offer.[30]

Despite many literatures have distinguished the disparity between a hostile and friendly M&A, because of increased application of financial resources by threatened corporations, antitakeover defenses became quite elaborate and more difficult to penetrate. As described in next section, in respect of increasing antitakeover activities after fifth merger waves early 1990s[31], M&A tactics have developed fast to against targets' protection. In addition, in order to avoid negative connotations, bidders sometimes contract with the targets by determining the deal with a "friendly" term. As a consequence, nowadays there is no long a clear borderline between hostile takeover and friendly takeovers. Therefore, in this thesis, we will not distinct the type of takeovers in each case study.

3.3 Disparity between Merger and Acquisition

By further studying some literatures, we acknowledged that when one company takes over another and clearly established itself as the new owner, the purchase is called an acquisition. From a legal point of view, the target company ceases to exist, the buyer "swallows" the business and the buyer's stock continues to be traded. Whereas, a merger happens when two firms, often of about the same size, agree to go forward as a single new company rather than remain separately owned and operated. This kind of action is more precisely referred to as a "merger of equals." Both companies' stocks are surrendered and new company stock is issued in its place. For example, both Daimler-Benz and Chrysler ceased to exist when the two firms merged, and a new company, DaimlerChrysler, was created.

[30] Gaughan (2007), "Mergers, Acauqisitions and Corporate Restrcuturings", John Wiley & Sons, Inc. Chapter 3 Legal Framework, Page69

[31] Gaughan (2007), "Mergers, Acauqisitions and Corporate Restrcuturings", John Wiley & Sons, Inc. Chapter 2 History of Mergers, Page 29

3.4 Phraseological M&A in this thesis

However, actual mergers of equals don't happen very often. Usually, one company will buy another and, as part of the deal's terms, simply allow the acquired firm to proclaim that the action is a merger of equals, even if it's technically an acquisition. Being bought out often carries negative connotations, therefore, by describing the deal as a merger, deal makers and top managers try to make the takeover more palatable. Moreover, an acquisition is also named a merger when both CEOs agree that joining together is in the best interest of both of their companies. But when the deal is unfriendly - that is, when the target company does not want to be purchased - it is always regarded as an acquisition.

Therefore, whether a purchase is considered a merger or an acquisition actually depends on whether the purchase is friendly or hostile and how it is announced. In our thesis, we will follow Gaughan and not to distinguish between merger and acquisition, considering them synonymous.

3.5 Motives for M&A - competitiveness theory

Many literatures have indicated that multinational corporations have been seeking for M&A to enhance their competitive advantage, in other words competitiveness is the pushing hand behind M&A.

Competitiveness in a specific country or industry results from convergence of the management practices and organizational modes favoured in the country and the sources of competitive advantage in the country or industry. Countries also differ remarkably in the goal that companies and individuals seek to achieve. On the other hand, the goals a nation’s institutions and values set for individuals and companies, and the prestige it attaches to certain industries, guide the flow of capital and human resources which directly affects the competitive performance of certain industries. In

addition, the emerged global and local rivals are in a final and powerful stimulus to the creation and persistence of competitive advantage.

Therefore, we conclude that in cross-border M&A, synergies, increased market power, control of suppliers and buyers, are the key motives that maximize the wealth of the shareholders of corporation.[32]

3.6 M&A Strategies - Convergency theories of value creation

Doukas and Travlos found that, unlike many domestic acquisitions, acquirers enjoyed positive (although not statistically significant) returns when they acquired targets in countries in which they did not previously have operations. Interestingly, the returns were negative (although also not statistically significant) when the acquirers already had operations in these foreign countries.[33] When the company is already in the market, and presumably has already exploited some of the gains that can be realized, then investors may be less sanguine about the gains that may be realized through an increased presence in this same region. Gaughan, Patrick A. states that, proponents of M&A will often point to an ability to grow faster and anticipated synergy as the justification for a successful deal.[34] Therefore, it is conclude that the M&A strategy including operating and financial synergy, market power, and control of suppliers and buyers are explored as following,

Synergy

Gaughan, Patrick A. indicates that synergy is the potential additional value from combining two firms. The term synergy is often associated with the physical sciences rather than with economics or finance. It refers to the type of reactions that occur when two substances or factors combine to produce a greater effect together than that

[32] Harward Business Review, March 2001
[33] John Doukas and Nicholas G. Travlos(1988), "The Effect of Corporate Multinationalism on Shareholder's Wealth,"Journal of Finance, 43, 1161–1175.
[34] Gaughan Patrick A. (2007),Mergers, Acauqisitions and Corporate Restrcuturings, Wiley, 4th Edition.Chapter 4, See page 117

which the sum of the two operating independently could account for. In mergers this translates into the ability of a corporate combination to be more profitable than the individual parts of the firms that were combined, which is the major objective that corporation would like to achieve in M&A.

He concluded that there are two main types of synergy which are operating synergy and financial synergy. Operating synergy comes in two forms: revenue enhancements and cost reductions. These revenue enhancements and efficiency gains or operating economies may be derived in horizontal or vertical mergers. Financial synergy refers to the possibility that the cost of capital may be lowered by combining one or more companies.[35]

The anticipated existence of synergistic benefits allows firms to incur the expenses of the acquisition process and still be able to afford to give target shareholders a premium for their shares.

Market power

Market power, which sometimes is referred as monopoly power, is defined as the ability to set and maintain price above competitive levels. Because in the long run sellers in a competitive industry only earn a normal return and do not earn "economic rent," competitive firms set price equal to marginal cost.

According to Gaughan, Patrick A., there are three sources of market power: product differentiation, barriers to entry and market share. Product differentiation can be achieved by extending product line or international coverage, and integrated R&D and innovation technology. Secondly, through horizontal integration, a company is able to increase its market share. Thirdly, it could be the case that even with a substantial increase in market share, the lack of significant product differentiation or barriers to

[35] Gaughan (2007), "Mergers, Acauqisitions and Corporate Restrcuturings", John Wiley & Sons, Inc. see page 12.

entry could prevent a firm from being able to raise its price significantly above marginal cost. Even in industries that have become more concentrated, there may be a substantial amount of competition.

Control of penetration

As more and more parties join together in form of M&A, industries have become more concentrated, a substantial amount of competition reinforce corporations to further penetrate the market. In order to see the effect of competition on M&A and gain the control of penetration among others, corporation need to see whether they manage the interests and benefits of external stakeholders such as customers, suppliers.

Customers may obtain better deals than their rivals (where customers are not end users but rather compete with each other).[36] Secondly, customers tend to avoid adjustment costs associated with changes in restructured firm operations.[37] On the other hand, in industries where customers are less sophisticated, their opposition to mergers may be based more on fears about change or uncertainty.

To obtain a competitive position, corporations should also understand interest and benefits of suppliers in host country, and build up their confidence in cross-border M&A. They are interested in the continuance of the company treat their suppliers with understanding and ensure that they settle their debts on time to maintain the confidence of these providers.

Therefore, good strategy in convincing them not only including the pricing strategy

[36] Joseph Farrell (2004), Listening to Interested Parties in Antitrust Investigations: Competitors, Customers, Complementors, and Relativity, ANTITRUST.
[37] Robert H. Lande & James A. Langenfeld (1998), Recent Trends in Merger Enforcement in the United States: The Increasing Impact of Economic Analysis, 15 NIHON U. COMP. L.J. 73, 94.

and costs management, but also maintaining a sustaining friendly relationship by building up their confidence of the M&A.

Conclusion

Giving all M&A theories presented above, although corporations often put plenty of efforts on M&A strategies, corporate governance will be the prerequisites for success of the deal, and currently there is not a corporate governance framework for cross-border M&A. In Chapter 6, we will present a framework for corporate governance in cross-border M&A as prerequisites.

3.7 Culture challenges

Once M&A comes into cross-border scope, financial synergies is not the single magnitude anticipation of decision makers, they also expect the harmony brought along the corporation with the host's overall environment, the new elected executive structure and integrated organizational culture.

Culture

When people talk about culture, it is fairly reasonable to interpret this concept in anthropology term, "culture is the foundational term through which the orderliness and patterning of much of our life experience is explained"[38]. Whatever people argue about culture issues, there is always something needed to be kept in mind that culture relates to unconscious philosophy and norms belong to human's nature or groups' internal shared and rooted value.

The culture influence of a company's business globalization can be evaluated according to several aspects. Organization's target market is expanded to a much broaden dimension. Facing diversified customer groups and suppliers with different

[38] Benedict, 1934

culture background, corporate strategies and organizational culture have to be adjusted to ensure it remains one organizational identity after integration and do not be diluted. Its marketing strategy should be captured by the target market accordingly so that the organization follows the norms, moral and regulations of the target market.

Organizational corporate culture

In modern society, organizations are more conscious about their competency in markets and optimization on operation and administration etc. They make prompt changes following corporate strategies, for instance M&A, in order to generate synergies and value. However organizational culture is always a controversial issue when managing organizational change. Prof. Geert Hofstede, Emeritus Professor, Maastricht University concludes that "Culture is more often a source of conflict than of synergy. Cultural differences are a nuisance at best and often a disaster." The same issue can be implicated that organizational culture is a magnitude aspect in organizational changes, especially in comparable management functions and the post-change overall performance.

According to Meadows (1967; 82) organization theory is always rooted in the imagery or order and "the development of theory or organization is history of the metaphor or orderliness"; and in anthropology term, "culture is the foundational term through which the orderliness and patterning of much of our life experience is explained"[39], the linking of culture and organization is the intersection of two sets of images of order: those associated with organization and those associated with culture.[40]

Nowadays, in order to surviving in the competitive market and keep competent position, many companies choose to expand their business through organization

[39] Benedict, 1934
[40] Linda Smircich, Concepts of Culture and Organizational Analysis, Administrative Science Quarterly, Vol. 28, No. 3, Organizational Culture , Johnson Graduate School of Management, Cornell University, Sep, 1983, pp. 339-358

restructuring- Mergers, Acquisitions and Expansion. Post-combined setting is more integrated in many ways, the workforce, the market, its products and customers, the organizational values and organizational culture. The integration of two independent individual requires identification of a re-formed organizational culture. In addition to the effects of mergers and acquisition, diversified workforce after cross-border expansion is a significant trigger of organizational change as well. In order to ensure different parties or culture groups acknowledge the same value of the new identity and hold together, initiatives of organizational culture changes programs are about to be launched.

Change of executive board or leadership is another trigger that results in the organizational culture changes. Many studies have proved that different styles of leaderships generated different images on its stock performance and concerns on employees. Therefore, the interests, ideas and ambitions of leadership will affect the whole organizational directions, mission, culture and value.

3.8 Control for M&A

Corporate governance control

Despite the pithy statement attributed to Friedman (1970) that the business of business is business, which arguably justifies an exclusive approach to corporations, multilateral bodies setting corporate governance standards believe that corporations and stakeholders must cooperate actively for creating wealth, jobs and financially sound enterprises.

An effective system of corporate governance has both **internal and external controls** that have to be sufficiently responsive if governance is to succeed,

Internal aspects include ownership structure, the board of directors and committees,

internal control, risk management, transparency and financial reporting.

External aspects can either be market-oriented, or can take the form of credit ranking, and/or social requirements.

Due to the original orientation of the Sarbanes/Oxley Law, concentrating solely on financial disclosure and given its decisive and tremendous influence on all other similar corporate governance legislations all over the world, most writings on corporate governance have dealt with solely internal corporate governance mechanisms.[41]

The internationally accepted framework believes that corporate governance is about maximising value subject to the corporation meeting its financial, legal and contractual obligations[42], which is well supported by views on the contractual nature of the firm. There may be important structural such and cultural factors that may make each corporate governance systems to approach the interest of stakeholders differently in practice.

Nevertheless, the main objective of the control is to identify and enhance the important structural aspects and critical cultural influences that determine the overall approach to stakeholders

Country regulation control

As an important element of global economic activity, Foreign Direct Investment (FDI) has received enormous attention from scholars worldwide.[43] And cross-border M&A was the main force behind the major rise of FDI around 2000.[44] Governments' policy

[41] Ahmed Naciri (2009), Internal and External Aspects of Corporate Governance, Routledge
[42] Iskander and Chamlou, 2000
[43] Brander and Spencer (1987), Ethier (1986), Helpman (1984), Hortsman and Markusen (1987), Itagaki (1979), Janeba (1995), Kayalica and Lahiri (2007), Markusen (1984), and Smith (1987)
[44] Brander, J. A., & Spencer, B. J. (1987). Foreign direct investment with unemployment and endogenous taxes and tariffs. Journal of International Economics, 22, 257–279.

measures regulating M&A activities affect the welfare of billions of consumers as well as the welfare of other economic agents such as employees and employers.[45] Researches claim that the regulatory policies should be subject to international negotiations or assigned to higher levels of government.[46]

Foreign firms are endogenous and can be affected by government policy in the host country.[47] Only because the host country government uses lump-sum profit subsidies to attract FDI in order to maximize social welfare, but also establish legal terms in national company low or antitrust law etc. This also infers the issue of increasing competition amongst countries trying to attract FDI. The Trade Related Investment Measures (TRIM) agreement that is based on the GATT principles on trade in goods and regulates foreign investment, does not govern the entry and treatment regulations of FDI. As a consequence, firms who plan to implement cross-M&A should acknowledge the target countries' regulations before entry, since the countries pursue local and international policies in order to regulate possible unfair competitive strategies in case of cross-border M&A.

3.9 Summary

M&A is a mixed of strategy making, behaviors and ideas of parties involved, and regulations. As a major international growth strategy, cross-border M&A cannot be examined solely as it was a financial technique, corporate governance is crucial in its success. In corporate governance the role of the board of directors, they oversee management, and efficiency of the boards integrated together are primarily examined among others as key drivers on corporate level, as well as interaction among all

[45] Benchekroun, H., & Chaudhuri, A. R. (2006). Trade liberalization and the profitability of mergers: A global analysis. Review of International Economics, 14(5), 941–957.

[46] In 2002, The Fair Trade Commission (FTC) of the South Korea government announced that it would introduce regulations by the end of that year. The FTC claimed that this would allow it to track mergers between foreign firms which could seriously impair relevant domestic industries. FTC signed an agreement with Australia in 2003 for the mutual application of Korea's fair competition law and would pursue similar agreements with the United States, European Union and Japan. Similarly, the European Commission has regulated mergers between foreign firms when they are affecting negatively the European interests.

[47] Ozgur M. Kayalica, Rafael S. Espinosa-Ramirez(2007), Brotherhood of competition: Foreign Direct Investment and domestic mergers, International Review of Economics and Finance

stakeholders in M&A on firm level. However, when M&A takes place cross-border, external control of governance, crash among corporate governance systems, and regulation and public effects are crucial facets to be taken into account as well. In chapter 5, we will demonstrate problematic track record of 4 cross-border M&A transactions, which consists in issues discussed in this Chapter. In Chapter 6, we will also further and construct a corporate governance framework for cross-border M&A.

Chapter 4 Theory of Corporate Governance

4.1 Theory selection

The four theories following below—agency theory, stakeholder theory, and transaction cost economics and stewardship theory are essential and fundamental in the development of corporate governance (Mallin 2004). The theories will be outlined and explained in order to provide the reader a general understanding of the overall corporate governance. Regarding cross-border M&A, thereby studies on the global corporate governance systems and the roles of CEO and board of directors in these M&A activities are constructing the key theoretical basis of our thesis.

4.1.1 Agency theory

An agency relationship arises when one or more principals engage another person as their agent to perform a service on their behalf. Performance of this service results in the delegation of some decision-making authority to the agent. This delegation of responsibility by the principal and the resulting division of labor are helpful in promoting an efficient and productive economy. However, such delegation also means that the principal needs to place trust in an agent to act in the principal's best interests.[48]

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[48] Agency Theory and the Role of Audit", 2005, Institute of Chartered Accountants in England &Wales.

In a corporation, due to the separation of ownership and control, shareholders (principals) who are the owner of a corporation often employ professional managers (agents) to manage the corporation and maximally generate returns on their funds. Agents are likely to have different motives to principals. They may be influenced by factors such as financial rewards, labor market opportunities, and relationships with other parties that are not directly relevant to principals. This can, for example, result in agents may also be more risk averse than principals. As a result of these differing interests, agents may have an incentive to bias information flows. Principals may also express concerns about information asymmetries where agents are in possession of information to which principals do not have access.

As a result of information asymmetries and self-interest, "the principals and agents effectively have a contract that specified what managers can do with the funds, and how the returns will be divided between them and shareholders. A problem is that as future contingencies can not be anticipated, complete contracts are not feasible. The principles and agents have to allocate residual control rights: the rights to make decisions not foreseen in the contract. Managers inevitably acquire considerable residual control rights, providing discretion over how to allocate investors funds. From this point of view, the subject of corporate governance concerns the constraints principles can put on agents to reduce misallocation of investor's funds."[49]

Agency theory has been recognized by people for long time and has a practical application. In Chapter 5, we will link this theory with empirical M&A cases worldwide.

4.1.2 Stakeholder theory

Stakeholder theory defines organizations as multilateral agreements between the

[49] Clarke Thomas (2007), p24

enterprise and its multiple stakeholders.[50] There are a lot of different definitions as to who or what constitutes a stakeholder, according to Crane A.& Matten D., a stakeholder of a corporation is an individual or group which either is harmed by , or benefits from the corporation; or whose rights can be violated, or have to be respected by the corporation.[51] Clarke Thomas divided a firm's stakeholders into two categories: internal stakeholders (employees, managers and owners) and external stakeholders (customers, suppliers, competitors, special interest group and the community). Both internal and external stakeholders are important and are constrained by formal and informal rules that business must respect. From this point of view, "corporations may be conceived as institutional arrangements for governing the relationships between all of the parties that contribute firm-specific assets."[52]

4.1.3 Transaction cost economics

A transaction cost is a cost incurred in making an economic exchange. The transaction cost is often viewed as closely related to the agency theory and for that reason considered as important in the corporate governance context. When rationally evaluating a potential transaction, it is essential to consider transaction costs that might prove significant.

Ronald Coase (1937) argues that the transaction costs are low when well functioning exchanges of corporate activities exist. This regards the gathering of information about available alternatives; first to evaluate them and secondly to conclude contracts with them. There are economic benefits for the firm to undertake transaction internally than externally. Furthermore, the firm will become larger the more transactions it undertakes and the expansion will continue until it becomes cheaper or

[50] Clarke Thomas (2007),p29
[51] Crane Andrew & Matten Dirk (2004), p50
[52] Blair 1995

more efficient for the transactions to be undertaken externally. Moreover, he argues that firms may become less efficient the larger they become (Coase 1937)

However, Williamson (in Nygaard & Bentgsson 2002) argues that corporations don't have to become less efficient the larger they become since they can choose governance structure.

Corporate governance structure plays an important role in a world with incomplete contracts, and where agency problems exist. The transaction theory presents, in relationship with the agency theory, a deeper understanding for costs, which are associated with activities internally in the corporation. The theories can be linked to managerial direction and control (Mallin 2004).

4.1.4 Stewardship theory

According to Clarke Thomas, stewardship theory maintains there is no inherent conflict of interest between managers and owners, and that optimum governance structures allow coordination of the enterprise to be achieved most effectively. Managers should be authorized to act since according to stewardship theory they are not opportunistic agents but good stewards who will act in the best interests of owners. Stewardship theory recognizes a strong relationship between managers' pursuit of the objectives of the enterprise, the owners' satisfaction, and other participants in the enterprise reward.

Stewardship theory stresses the beneficial consequences on shareholder returns of facilitative authority structures which unify command by having roles of CEO and chair held by the same person.[53]

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[53] Donaldson Lex & Davis James H (1991)," Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns" Australian Journal of Management, 16,1, June 1991. The University of New South Wales.

Some failures of M&A cases were caused by the management or decision-makers who did not recognized the relationship between the goals of themselves and the interests of other participants in the company. As a result of lack of understanding and applying stewardship theory, there occurred that the CEOs pursued their own benefits at the cost of others' interests, and then sometimes both failed at the end. Regarding this, evidence will be found in the case study in Chapter 5.

4.2 The global corporate governance systems

The complexity of corporate governance can be explained through its global occurrence including different legal, cultural, ownership, and other structural differences. Different traditions, values and objectives will undoubtedly continue to produce different outcomes in governance, which will relate closely to the choices and preferences people exercise in engaging in business activities. Generally speaking, there are four groups of countries where different corporate governance systems can be identified[54]:

(a) Anglo-Saxon, (representative countries: USA, UK, Canada, Australia, NZ)

(b) Germanic, (representative countries: Germany, Sweden, Netherlands, Switzerland, Norway, Finland)

(c) Latin, (representative countries: France, Italy, Spain, Brazil, Belgium)

(d) Japanese, (representative countries: Japan)

The Anglo-Saxon system is a market-oriented system which serves as a mechanism for independent shareholders to influence managerial decision-making. The influence of the shareholder is strongly institutionalized in the Anglo-Saxon countries. This system has adopted a one-tier board of directors, i.e. governance with one level of directors, making no distinction but executives and non-executives. The stock and

[54] Clarke Thomas (2007), p102

bond markets play an important role but the Anglo-Saxon system is primarily characterized by the external market for corporate control, also named as the takeover market. As a result, high compensation is based on a high level of performance. The ownership concentration is low and the economic relationships are relatively short-term.

When discussing the Germanic system, Germany is the country referred to although a range of smaller countries are divided into this system as well. Germany has a two tier board system, i.e. executive and supervisory board. The supervisory board is composed of employees and shareholders that can influence managerial decision making. The banks have an especially important role in Germany due to their large block holdings. The ownership concentration is consequently very high and the economic relationships are preferably long-term.

The Latin system lies somewhere in between the Anglo-Saxon and the Germanic Systems .In France the companies can chose between one-tiered or two-tiered board systems. Shareholder influence is somewhat stronger then in the Germanic system, than but not as strong as in the Anglo-Saxon. Ownership concentration is generally high in the Latin system. Moreover, family owned corporations are very common, particularly in Italy and for that reason is the long-term economic relationship preferable.

Both Japanese and Latin corporate governance systems are network-oriented, but the Japanese board system is rather complex, an informal substructure of the board of directors is often constructed. Similar to Germany are the banks and employees essential stakeholders. In Japanese corporate governance system, compensation based on performance is low, as in Germanic countries.

Cross-border M&A are inevitably related to different corporate governance systems in different countries, in Chapter 5, according to four M&A empirical cases, we will

study how different corporate governance systems influence the company's governance structure, decision-making and so on.

4.3 Two important roles

4.3.1 The role of CEO

According to Tengblad Stefan (2004)[55], the role of top executives is interpreted as efforts to manage internal and external expectations. The CEO is viewed as an expectation handler. The CEOs have to make their own interpretations about which expectations are important to align to, and are trying to reconcile different expectations into a more consistent agenda (compare Kotter 1982) that is continuously communicated both externally and internally.

The level of expectation creates a climate of impatience inside the companies, the shareholders expect superior returns on their investments, otherwise they would never have made the investment, and if they believe that the company will no longer provide superior returns they will probably sell their shares. The CEOs in their turn are evaluated on the basis of how well the share performs.

They were more and more aligned with the idea of shareholder value maximization by an ideological commitment, financial rewards and the risk of getting fired.

CEOs have been influenced by the shareholder value movement in a way that makes them receptive towards expectations from financial market actors, for example, strong cash flows, and large profits. They spend a lot of time communicating with the financial market, and sometimes top management can bypass the board. Evidence will be found in DaimlerChrysler case study in Chapter 5. Daimler-Benz CEO Jürgen Schrempp intended to maximize shareholders' value and enhance Daimler's financial

[55] Tengblad Stefan, "Expectations of Alignment: Examining the Link between Financial Markets and Managerial Work" Gothenburg Research Institute, Sweden.

performance through the merger with Chrysler Corp. However, finally he destroyed shareholders' value as a result of the unrealistic synergies, mismanagement and other factors.

4.3.2 Role and responsibilities of board of directors

The board of directors is the fulcrum of corporate governance: the critical nexus in which the fortunes of the company are decided. According to Carter and Lorsch (2004:67) boards are essentially involved in three distinct activities: monitoring the company and management performance; making major decisions; and offering advice and counsel to management, especially the CEO. Therefore, three key roles of the board can be conceived as[56]:

1 The control role (dominating role): to hire and fire TMT, non-executive directors; monitoring the management of the company and ensuring accountability.
2 The service role: providing board capital through creation of networks and specialist competence; experienced directors are especially helpful to give some useful and practical suggestions; financial capital supply; supported by research about SMEs[57].
3 The strategy role: approving and monitoring the strategic direction of the company.

To conclude, on the one hand, the board is responsible internally for the leadership and guidance of the corporate entity; on the other hand, the board has a wider set of external responsibility, firstly towards investors, "The board is the link between the shareholders of the firm and the managers entrusted with undertaking the day-to-day operations of the organization" (Stiles and Taylor 2001:4); and secondly towards the wider stakeholders who are the essential partners of the entity.

According to some previous research and literatures, it is clear that in different companies, the types of boards are also different. There are some factors influencing

[56] Clarke Thomas (2007), p33.
[57] According to resource dependency theory

the type of board such as size of the company, ownership structure, the company's development phase and power, skill and will of the directors.

Regarding the board of directors, we will further explore and analyze what role board of directors played in Vodafone-Mannesmann merger case in Chapter 5.

4.4 Corporate governance in cross-border M&A

Comparative study examines one source of these differences - national systems of 'corporate governance' (i.e. the set of mechanisms that control and influence senior management). Nowadays, cross-border M&A is the main feature of industrial restructuring worldwide.[58] There have been plenty of researches of corporate governance in the literatures over the past decade. Accounting scandals such as those that occurred at Enron, Adelphia, and WorldCom have brought much attention, which led to changes in laws and accounting rules in an effort to achieve more accurate reporting of financial data to markets. However, governance related to cross-border M&A has not incurred the same degree of focus. By understanding the nature of M&A and when it comes into cross-border scope, there is still a long way to go to investigate corporate governance problems as determinants of successful corporate restructuring.

Corporate Governance is concerned with holding the balance between economic and social goals and between individual and communal goals. In cross-border M&A new issues in corporate governance are emerged and this area became even much magnified. All components selected can no longer be examined individually, either merely based upon previous researches. In this thesis, we will begin to investigate the problems of corporate governance according to current research on corporate governance in cross-border M&A and supplement evidences of new findings.

[58] The European Industrial Relations Observatory (EIRO) is a monitoring instrument offering news and analysis on European industrial relations.

Therefore, our new framework will focus on both internally and externally. The internal governance will cover the responsibility of CEO and related issue, stewardship policy, self-regulation, role of organizational culture, roles of owners, managers and employees as well as their inter-relationship etc. The external governance will focus on both bidder's and target's country cultures, regulations, interests of external stakeholders, and public pressures from both original countries; and the conflicts among each.

4.5 Summary

In this chapter we introduced some corporate governance theories; actually, most corporate governance problems could trace back to these theories per se. Firstly, we simply introduced four well-known corporate governance theories, which we thought is necessary to mention again. Then, considering that cross-border M&A usually connects with different corporate governance systems in the global arena, we mainly described the corporate governance systems' characters from four groups of countries, Anglo-Saxon, Germanic, Latin and Japanese. In the next chapter, four cross-border M&A cases will be analyzed which associate different corporate governance systems among England, Germany, USA, France and China. Finally, we selected two important participants for corporations especially when experiencing international M&A --CEO and board of directors, and described their roles and responsibilities. All these theories of this chapter would be a foundation for further analysis and studies in the following chapters.

Chapter 5 Empirical cases studies

In order to build up a conceptual framework in Chapter 6, we not only employ fundamental theories in Chapter 3 and Chapter 4 on the factors behind mergers and acquisitions, but also introduce four cross-border M&A cases study to provide

supplement evidence of corporate governance problems in cross-border M&A, to materialize the theories and complete our conceptual framework in Chapter 6.

5.1 Vodafone-Mannesmann Merger

5.1.1 Background

In 2000, Vodafone Airtouch Plc took over Mannesmann AG, successfully completing the first hostile bid for a German company. In fact the $195billion takeover was the largest merger and takeover deal in the world[59]. Vodafone was able to use the growing power of its stock market capitalization in leveraging the takeover of the industrial giant Mannesmann which had at the time 114,000 employees, DM 40billion in turnover, and was 109 years old. In contrast to the century-long industrial heritage of Mannesmann, however, Vodafone was a newer and smaller enterprise with 12,600 employees, DM 11billion in turnover, and only 15years old[60]. What was ultimately the reason which allowed Vodafone to acquire a much larger company than itself?

5.1.2 Analysis

Mannesmann's loss was firstly attributed to its management. In the union view, management had not prepared an adequate strategy that addressed Mannesmann's diverging business areas. Mannesmann management had pursued the telecom business at the expense of the established engineering and manufacturing business Mannesmann was founded on. However, where was the board when Mannesmann's CEO Esser proposed to change Mannesmann into a focused telecommunications company? Why did they not question it in light of Mannesmann's historical business structure and difficulties the firm would face?

On the other side, Mannesmann's management main defensive strategy during the

[59] Clarke Thomas, 2007, pp402
[60] ibid

takeover was singularly ill-conceived when it had a fragmented ownership structure and did not have majority support from non-management quarters. Using an unreliable partner such as Vivendi to fend off a tough partner like Vodafone simply made things worse for Mannesmann. As some shareholder activists accused afterwards, Mannesmann's CEO Esser severely hurt the interests of shareholders by spending large amounts in the failed takeover defense. Once again, where was the board at this time?

As to the end of this merger event, we have to say that Mannesmann's chairman of management Klaus Esser was one of the biggest winners who received a severance payment of DM60 million, which was unheard of in Germany.

With 80 percent of jobs in Mannesmann being in the non-telecom area, unions were more concerned about the heavy job losses resulting from any consolidation process. In addition to Mannesmann's changes on its business focus area, employees were not so united and creative as before, co-determination was not as developed in the telecommunications business. Subsequently, distressed by the rapidity of the Mannesmann capitulation, German unions announced their plan for using pension funds and employee share ownership to promote employee-oriented corporate governance.

There is a dominated opinion that Vodafone was able to take over a German company five times its size due to its current market valuation. As The Financial Times pointed out, this Anglo-American valuation of companies by the market was a new form of capitalism that was alien to Germany. Actually, in this case, two different corporate governance systems were the foundation and played a significant role in the transaction. The German corporate governance system is derived from its social market economy which emphasizes consensus in decision-making, and partnership

between capital and labor[61]. While Anglo-American model pursues high share price, regards valuations as the major source of leverage in global expansion and consolidation.

5.1.3 Conclusion

As Clarke Thomas summarized in his book, the Mannesmann takeover demonstrated a profound inertia and deep resistance in Germany towards the global trend of emphasizing the importance of shareholder value above all corporate objectives. In consequence, at least one approach in Germany is developing a novel hybrid model of governance characterized by the institutionalized participation of labor within an increasingly open capital market[62].

5.2 Daimler-Chrysler Merger

5.2.1 Background

On 7th May, 1998, the CEO of Chrysler Corporation Eaton announced that Chrysler would merge with Daimler-Benz. Thanks to a $37 billion stock-swap deal, the largest trans-Atlantic merger ever, Chrysler would not "do it alone" any longer[63].

Daimler-Benz CEO Jürgen Schrempp hailed the union as "a merger of equals, a merger of growth, and a merger of unprecedented strength". The combined company, with 442,000 employees and a market capitalization approaching $100billion would be the fifth largest automaker in the world[64].

However, in 2007, Daimler indicating Chrysler was for sale signaled that the partnership was failing.

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[61] Clarke Thomas (2007), pp402

[62] Clarke Thomas(2007), pp414

[63] The merger announcement of Daimler and Chrysler, http://www.grin.com/e-book/37343/the-daimlerchrysler-merger-one-company-two-cultures

[64] “The DaimlerChrysler Merger”, Tuck School of Business at Dartmouth, no.1-0071

5.2.2 Analysis

Mismanagement:

When DaimlerChrysler Chief Executive Schrempp sealed the merger of Daimler Benz and Chrysler Corp. in 1998, he told shareholders to "expect the extraordinary" from the $157 billion, world-spanning auto company. However, the large loss happened during recent years has showed that his grand scheme has proved extraordinary -- but for all the wrong reasons. Unbelievably, Schrempp blamed a tough U.S. market -- but at the same time savvy Japanese auto makers have increased U.S. sales and produced a profit[65].

In August, Daimler paid $300 million to settle a class action that claimed Schrempp misled investors when he called the deal "a merger of equals." [66]

During 1998-2001, Chrysler was neither taken over nor granted equal status. It floated in a no man's land in between. The managers who had built Chrysler's "cowboy bravado" were no more. Some remained on staff, feeling withdrawn, ineffective and eclipsed by the Germans in Stuttgart. Others left for a more promising future at G.M. or Ford. The American dynamism faded under subtle German pressure, but the Germans were not strong enough to impose their own managers[67]. In fact, Daimler-Benz was the majority shareholder in the conglomerate. It controlled the majority of seats on the Supervisory Board.

Lack Transparency:

German CEOs, for example, are not required to publish their compensation until 2006. Only the total executive pay for a group of top managers must be revealed. That allowed CEOs who destroyed shareholder value, such as Juergen Schrempp, to hide

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[65] **"**The Worst Managers: Jurgen Schrempp; DaimlerChrysler" **Business Week.** New York: Jan 12, 2004. , Iss. 3865; pg.72http://proquest.umi.com.ludwig.lub.lu.se/pqdlink?Ver=1&Exp=10-26-2008&REQ=1&Cert=lXu3PbBnxTzlrF7ZLHL04vTPSFbjpPSRoP0qt7habI9jgm9Yq4qrPKI%2fi9WCStPl&DID=522737421#indexing

[66] Ibid

[67] "The DaimlerChrysler Merger", Tuck School of Business at Dartmouth, no.1-0071

behind a pay smokescreen year after year and dodge accountability. Fund managers fumed helplessly as the overall payment for Schrempp and his top team grew by multiples despite a dismal performance.[68]

Culture clash:

Culture clash has been eroding the anticipated synergy savings. Much of this clash was intrinsic to a union between two companies which had such different wage structures, corporate hierarchies and values. American workers earned appreciably more than their German counterparts, sometimes four times as much.

Chrysler and Daimler-Benz's brand images were founded upon diametrically opposite premises. Chrysler's image was one of American excess, and its brand value lay in its assertiveness and risk-taking cowboy aura, all produced within a cost-controlled atmosphere. Mercedes-Benz, in contrast, exuded disciplined German engineering coupled with uncompromising quality. These two sets of brands, were they ever to share platforms or features, would have lost their intrinsic value. Owing generally to brand bias, distribution and retail sales systems had largely remained separate as well.

In addition, there occurred large rifts in business practice and management sentiment, although DaimlerChrysler's Post-Merger Integration Team spent several million dollars on cultural sensitivity workshops for its employees.

5.2.3 Conclusion

The DaimlerChrysler merger showed a genuine spirit of coexistence between different accounting and corporate governance systems. Under the German system stakeholder values encompasses the interests of both the shareholders and employees. German corporations have been perceived as relying more on teamwork than on individualistic

[68] "DaimlerChrysler comes clean(finally)", Business Week, http://www.businessweek.com/autos/autobeat/archives/2006/02/daimlerchrysler.html

charismatic managers, which allowed the management board of the company exclusive right to manage and represent the company and work independently of shareholder interests and supervision [69]. As Clarke Thomas described, “The DaimlerChrysler transaction may well establish a model for a German version of shareholder capitalism that would expose managers to a new level of capital market pressure to perform for shareholders, which would be far more disruptive of established patterns of governance and political economy. “[70]

5.3 Danone and Pepsi M&A speculation

5.3.1 Background

Danone shares had climbed 32% to 96.25 Euros on 20th July from 72.7 Euros on 30th June amid three weeks of persistent rumors that the company was about to be acquired by PepsiCo. It might be never known that if Pepsi was indeed interested in buying Danone, though it would have been a good fit. Danone’s products are far healthier than the fizzy drinks and salty snacks in Pepsi’s portfolio. And Danone is one of the biggest purveyors of bottled water in Europe and Asia, while Pepsi is the largest in the U.S.

On the subject of a hostile bid for Danone, Finance Minister Thierry Breton stated that: “France is not the wild west. We have a strict framework of laws, and we will ensure that the law is applied so that the interest of employees will be protected.” Patrick oilier, head of the economic affairs committee in the National Assembly, vowed he would enlist the help of French institutional investors to fortify the Danone barricades against the foreign hordes.[71] Shares of Danone dropped 9% after **PepsiCo** (nyse: PEP - news - people) of the U.S. told French regulators that it is not preparing a bid for Danone (nyse: DA - news - people)[72]

[69] Ibid
[70] Clarke Thomas, 2007, pp398
[71] Franck Riboud, Matthew Gwyther. Management Today. London: Aug 2006. pg. 38, 3 pgs
[72] Danone: Not For Sale, Deborah Orr, Forbes, 07.25.05, 1:45 PM ET

5.3.2 Conflicts

However, there has been already emerged some obstacles for integration. First of all, France government pledged to "defend France's interests", with vowing to keep Danone in French hands as it was declared - like defense or the nuclear power industry - a matter of national security. As Lutgart Van den Berghe[73] demonstrated at level 5 in the debates of corporate governance framework, corporate governance is therefore viewed more from a macro angle and refers equally to the national, the European, or the global level[74].

Secondly, Danone's chairman, Franck Riboud, who took over management of the company from his father, has also expressed his desire to keep Danone independent. At the time of rumors, a French government-controlled bank Caisse des Dépots et Consignations holds a 3% stake in Danone, which isn't enough to block Pepsi outright. But France has thwarted other proposed corporate takeovers by exerting pressure on French institutional investors, which own 29% of Danone. Another 14% of shares are held by Danone managers and the company's treasury and pension funds. Furthermore, under company bylaws, a two-thirds majority of shareholders would be required to approve a takeover. Any purchaser must alert the company whenever 0.5% of the shares are purchased. Failure to do so means a loss of voting rights for two years. Second, no single shareholder can control more than 6% of the votes, unless the voting laws are changed, and that requires control of two-thirds of the company. That means, in theory, an acquirer could build up a 66% stake in Danone but still have only 6% of the vote.

Finally, The Anglo-American system of governance favors the shareholder approach,

[73] Lutgart Van den Berghe, University of Gent, Belgium
[74] Lutgart Van den Berghe(2002), Corporate Governance in a Globalising World: Convergence or Divergence?, Springer US, Chapter 1, page 3

whereas certain Continental European countries favor the broader stakeholder approach. As analyst Robert van Brugge of Sanford Bernstein & Co. in New York[75] says "Not only would they have to overcome political opposition, but there would be a very difficult cultural integration,"[76].Even if Pepsi surmounted that hurdle, having Danone fall into foreign hands could trigger a backlash among French consumers, who account for about one-fourth of Danone's global sales. Moreover, Danone has the corporate culture of a small company – the employees feel it's their company. Danone key managers would probably quit in droves if there were a hostile takeover.

5.3.3 Conclusion

Instead of speculating the synergies and relationships among participants in post-integrated corporation, researchers and the publics concerned with Danone have placed their emphasis on the conditions that admit this takeover. Those facets involved are essential in success of cross-border M&A with regard to significant contextual and industrial variables debated in external control of international corporate governance, which includes the role of governments in cross-border M&A, differences in corporate governance systems, culture influences and the interests not only limited to shareholders but also of other stakeholders such as key managers, employees and customers etc.

As to the means of corporate governance in this case, the boards of both Pepsi and Danone are not the mere decision makers but also involved other stakeholders who came to shove. And the ultimate control will be a hybridized power of those participants. When the takeover speculation of Pepsi became zero sum game, it was clear that the deal must prefer the interests of major stakeholders over all others.

[75]Carol Matlack (2005), Could PepsiCo Digest Danone?, BusinessWeek, JULY 21

5.4 Danone's M&A in China

5.4.1 Background

Group Danone, the third largest food group in Europe, entered Chinese market as a precursor as early as 1987. In the past 20 years, it has kept on investing in all the leading Chinese domestic enterprises of beverage or dairy industry stimulating by its "acquisition gene" in its nature.

However, in the recent one or two years, Danone has slowed down its pace in M&A and expansion in China. Chinese firms' sense in commercial interest is awaking, with considerable awareness of "Industrial Safety" and "Nationalism". These facts can be proved by a major failed expansion attempt of Danone in China.

5.4.2 Conflicts

In 1996, Danone established five joint venture companies with Hangzhou Wahaha Group. Then the number gradually increased to 39. By the end of Asian Financial Crisis, Danone offered Wahaha a bid quoting 4 billion Yuan (USD 571.4 million) for the merger and acquisition of 51% of the share of Wahaha's non-joint-venture companies that competed directly with those formed in concert with Danone.

As a consequence, on 19th July, 2007 four subsidiary companies of Danone, NOVALC Pte. Ltd., Festine Pte. Ltd., Jinja Investments Pte. Ltd. and Myen Pte. Ltd. filed derivative actions against Mr. Zong, in all likelihood alleging breach of fiduciary duties by engaging in competitive activities that injured shareholders' interests.[77]

[77] Danone and Wahaha Sue Each Other for Acting Against Reasonability of Noncompetition, SHANGHAI SEC. NEWS, July 20, 2007, http://finance.sina.com.cn/chanjing/b/20070720/02403803042.shtml

These provisions have been denied by Zong Qinghou Chairman of Wahaha. From Zong Qinghou's point of view, the JV products were sold primarily in coastal regions, while NJVE products were distributed in China's interior. And the Jion Venture agreement of 1996 was unfair that non-compete terms were not set to restrict Danone, and Danone had intention to control China's beverage market. In addition, this also raised the public attention regarding legislative process on anti-monopoly issues foreign mergers and acquisitions should go through the anti-monopoly check, and China should promulgate Anti-Monopoly Law.

5.4.3 Analysis

Potential risks lurked behind establishment

The Joint ventures were formed before the newly amended company law came into effect.[78] Group Danone and Peregrine Investment Holdings Limited contracted with Wahaha and capitalized the five joint ventures with RMB 560 million.[79] Wahaha, on the other hand, chose to avail itself of a provision in the Company Law that allows a shareholder in a Limited Liability Company to meet its initial capitalization requirement with intellectual property.[80] However, the mark was originally a state-owned asset, which would leave both Wahaha and the other shareholders liable for the shortfall in registered capital.

Board, ownership, and control

The two foreign investors took a combined 51% of the Joint Ventures, while Wahaha took 39%, and employees took 10%.[81] Pursuant to article 35 of the Old Company Law, however, shareholders could transfer all or part of their investment to each other

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[78] Company Law of the People's Republic of China art. 23 (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 1993, amended Dec. 25, 1999 and August 28, 2004) [hereinafter Old Company Law]. The New Company Law lowers the minimum capital requirement to 30,000 if a limited liability company has two or more shareholders.

[79] See Danone set to sue Wahaha Over Breach of Contract, South China Morning Post, April 11, 2007, p. B3 (assuming an 8:1 RMB:USD exchange rate).

[80] Old Company Law art. 25. Cf. New Company Law art. 27.

[81] Wikipedia, Wahaha, http://en.wikipedia.org/wiki/Wahaha, Dec. 13, 2007

without the approval of other shareholders.[82] Wahaha failed to realize that when it formed the joint ventures with Danone and Peregrine Investment Holdings Limited, that Danone could take control of the joint venture simply by purchasing Peregrine's 25.5% of the JV and adding it to its own 25.5%, thereby relegating Wahaha from the majority to the minority.[83]

Furthermore, according to Chinese Company Law, a limited liability company need not contain a board of directors.[84] But the primary JVE entity has a board of directors, and Danone in all likelihood has used its dominance of the joint venture board to appoint an interim chairman to replace Zong,[85] because voting rights in such a limited liability company are based upon capital contributions, absent contrary provisions in the company's articles of organization, Danone may have triggered the interim meeting using that provision based upon its capital contributions to the company, which in all likelihood exceed those of Wahaha.[86]

Competition

Indeed Danone has directed its directors to install Emmanuel Faber, "the head of Danone Asian operations, as the interim chairman of Wahaha."[87]. Up to 19th December, 2007, Danone maintained a joint venture with Chinese milk processor Mengniu Dairy, held more than one fifth of a company called Huiyuan that is China's biggest producer of juice drinks, and maintained "partnerships with several other well-known local firms including Shanghai's Aquarius."[88] It can be theorized by the Wahaha's stakeholders that, by virtue of its control of the Danone-Wahaha joint ventures, Group Danone owed a Wahaha a duty of loyalty that should have foreclosed

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[82] Transfer to an outside shareholder would have triggered a preemptive purchase right, but since Peregrine sold its shares to existing shareholder Group Danone, that right was never triggered. *Cf.* New Company Law art. 72.

[83] Steven M. Dickinson, Danone v. Wahaha, CHINA ECON. REV., Sept. 2007, available at http://www.chinaeconomicreview.com/cer/2007_09/Danone_v_Wahaha.html.

[84] New Company Law art. 45, 51.

[85] David Barboza, Rancor Level Rises in Rift Over Danone China Venture, N.Y. TIMES, June 9, 2007, available at http://www.nytimes.com/2007/06/09/business/worldbusiness/09danone.html.

[86] New Company Law art. 43.

[87] Barboza, supra note 67.

[88] Donny Kwok, Danone Pullout Hits Shares in Top China Milk Firm, GUARDIAN UNLIMITED (LONDON), Dec. 19, 2007, http://www.guardian.co.uk/feedarticle?id=7163717.

investment in other ventures by holding shares and appointing the same board directors in the competitors of the Danone-Wahaha joint venture.

5.4.4 Conclusion

Due to potential problems in a poorly-structured governance system in conjunction with cross-border M&A expansion, those conflicts occurred will exaggerate the complexity of the problems involved.

As reported, Danone did not involve itself in the daily management and operation of its China JVs, a strategy that seems to have backfired in many respects. The multi-national corporations such as Danone may have missed out its own strategy in China and may have lost customers because of media.

On the other hand, Danone's M&A activities also represent the current challenge for foreign direct investment to Chinese firms that that internationalization of business entails the separation of nationalism and commercial interests. Claessens and Fan in a review of corporate governance issues in Asia emphasize the lack of protection of minority rights insisting that most studies do not suggest that firms in Asia are badly run, but "the conventional governance mechanisms were weak to mitigate to the agency problem, as insiders typically dominated boards of directors and hostile takeovers were extremely rare. Neither did external financial markets provide much discipline, partly as there were conflicts of interest, but mostly as there existed rents through financial and political connections, which combined with the moral hazard of a large public safety net for the financial system"[89]

5.5 Summary

The empirical data collected comprises of 4 cases study that has been investigated in

[89] Thomas Clarke, International Corporate Governance, Chapter 6 Asia Pacific Corporate Governance P200. London and New York: Routledge

order to allow comparison and integration, by using conceptually selected and theoretical framework in Chapter 3 and Chapter 4. The information availability on each individual case varies, due to time of occurrence and varied major conflicts of M&A. We found that corporate governance systems crash, role of CEO and board, interests of stakeholders, stewardship policy, culture challenges, government regulations, role of media and public ideas have sustaining influence on cross-border M&A. In the following chapter, this thesis will go further and construct a corporate governance framework for cross-border M&A and refine this framework by new findings from an “on progress” M&A in China.

Chapter 6 A corporate governance framework for cross-border M&A

Summarizing 4 cross-border M&A cases study in previous sections; we construct a corporate governance frame work which covers fundamental theories in Chapter 4 and the evidences from the 4 cases in Chapter5. The findings can be divided into two branches, self-regulations within the corporation and external factors. Therefore, a conceptual cross-border M&A is systematically constructed based on both internal and external mechanisms. In contrast to traditional corporate governance failures and related researches on corporate scandals and management failures, this framework adopted a comprehensive approach which presents corporate governance problems in cross-border M&A and how they might be solved. Last, instead of listing abstract theories, this framework will materialize our findings and link them to theories.

<table>
<tr><th colspan="5">Figure 1 A conceptual corporate governance framework</th></tr>
<tr><th colspan="2">Merger and acquisition
Corporate Governance</th><th>Synergy</th><th>Market power</th><th>Control of penetration</th></tr>
<tr><td rowspan="9">Internal</td><td rowspan="2">Board of directors</td><td colspan="3">Problem: Directors are always compliant with management, not properly take the oversight role.</td></tr>
<tr><td colspan="3">Solution: Directors should remember to ask questions, be sensitive to the type of information that indicates increased risks or negative trends, track M&A activities of the company they are serving, seek multiple sources of information.</td></tr>
<tr><td rowspan="2">Internal self-regulation mechanism(Auditors, employees, executive compensation structure)</td><td colspan="3">Problem: Audit quality affects the accuracy of financial results, risk assessment etc.; Employees if not perform well, will erode the anticipated synergy, weaken the market power, even lose competitiveness; A reasonless executive compensation structure will increase the conflicts of interests between owners and managers, negatively affect corporate performance which is related to market share, control of penetration etc.</td></tr>
<tr><td colspan="3">Solution: Companies should enhance companies' internal self-regulation mechanism--independent auditors, employee-ownership, and maintain a sustaining friendly relationship with employees, toughen pay-for-performance metrics.</td></tr>
<tr><td rowspan="2">Managerial overconfidence</td><td>Problem: may overestimate the synergy gains of the potential merger.</td><td>Problem: inadequate post-merger planning causes M&A failures, bad performance, the decrease of market share, shrink international coverage etc.</td><td>Problem: managers always stay on the same level, may lead to the loss of competitive advantage as more and more entrants enter such contestable markets quickly.</td></tr>
<tr><td colspan="3">Solution: Managers should overcome overconfidence especially in high-risk cross-border M&A; board of directors should prevent and keep alert of managerial overconfidence.</td></tr>
<tr><td rowspan="2">Shareholders</td><td colspan="3">Problem: shareholders' different interests, may exaggerate the potential synergy, impact the decision whether to M&A or not.</td></tr>
<tr><td colspan="3">Solution: More communication with shareholders is needed for managers; the decision-making process going transparency is the trend to meet the information needs from shareholders.</td></tr>
<tr><td>organizational culture</td><td colspan="3">Problem: culture clash in the combined company may erode the anticipated synergy savings.</td></tr>
</table>

<table>
<tr><td></td><td></td><td colspan="3">Solution: Managers should recognize organizational culture differences and take into account when making decisions.</td></tr>
<tr><td rowspan="10">External</td><td rowspan="2">Country norms and value</td><td>Problem: pre-condition of generating synergy.</td><td>Problem: pre-condition of gaining market power.</td><td>Problem: pre-condition of controlling penetration.</td></tr>
<tr><td colspan="3">Solution: management should understand target's host country's culture, such as value and ethics that will determine the nature of a corporate management style, governance and communication custom, and decision makers' interests and behavior etc. to process the cross-border M&A smoothly.</td></tr>
<tr><td rowspan="2">Stock market</td><td colspan="3">Problem: Almost every M&A activities even not really happened (rumors, news, announcement about possible M&A) would induce the fluctuation of stock price of participant companies, so would financial crisis.</td></tr>
<tr><td colspan="3">Solution: Company participants should be aware of the reaction of stock market as corporations' external control.</td></tr>
<tr><td rowspan="2">corporate governance systems</td><td colspan="3">Problem: pre-condition of cross-border M&A.</td></tr>
<tr><td colspan="3">Solution: management should acknowledge the other firm's corporate governance system base and coordinate its strategy to favor the interest of domestic parties, in order to avoid a culture clash among different corporate governance systems.</td></tr>
<tr><td rowspan="2">Government legislation and regulations</td><td colspan="3">Problem: prerequisite of cross-border M&A approval.</td></tr>
<tr><td colspan="3">Solution: cross-border M&A should be constructed or adjusted in compliance with the host countries' regulations.</td></tr>
<tr><td rowspan="2">Interest of external stakeholders</td><td>Problem: external stakeholders' behaviors determine if M&A gains anticipated synergy.</td><td>Problem: entry barriers External stakeholders' opposition might dilute the market power.</td><td>Problem: external stakeholders may fear of the change of integration, and conserved of their behaviors and decisions.</td></tr>
<tr><td>Solution: management should optimize the interests and benefits of customers, creditors and suppliers in M&A to save costs and increase market shares</td><td>Solution: management should employ product differentiation strategy and sustaining R&D to reach a dominant position in the market</td><td>Solution: management should build up confidences of external stakeholders and sustaining relationship with them.</td></tr>
</table>

	Media function and public pressure	**Problem**: pre-condition of cross-border M&A.
		Solution: management should communicate with the media and govern itself on its activities, in order to convince the society to perceive the corporation and its activities as a "responsible citizen" and will not harm the interests and benefits of the domestic parties.

6.1 Internal governance

Internal governance comprises the self-controls within the corporate at management and firm level. The internal governance is the main dimension in corporate governance, which comprises tradition corporate governance theories of agency theory, stakeholder theory, stewardship theory and transaction cost economies. Conflicts and corporate governance problems raised in Chapter 5 are linked to those theories. We concluded as following.

6.1.1 Board of directors

The relationship between the board and top management is particularly important to maintain good corporate governance. "Corporate governance involves a healthy balance of honesty and trust with accountability and skepticism."[90] Therefore, board members must be sensitive to the type of information that indicates increased risks or negative trends that warrant further attention. Of course, M&A activities which to some extents are connected with companies' future fates are high-risky and should be paid more attention. According to the theory presented in Chapter 4, board of directors must remember to ask questions, be wary of jargon answers, admit they do not understand, and seek multiple sources of information-including from outside consultants. As reflected in the cases in Chapter 5, there existed M&A failures which were caused by the missing of board of directors when some unsatisfied or doubtable corporate behavior happened. Directors were always compliant with the management.

[90] Roche Marianne, "Digging Deeper Into Corporate Governance", Community Banker; Dec 2008; 17,12; ABI/INFORM Global pg.46.

6.1.2 Internal self-regulation mechanism

Audit committee

According to the agency theory, an audit committee seems necessary as a result of the relationship between principals and agents. When audit committee performs its duty to exam risk issues related to the company's M&A activities, these may involve complex matters that companies face in the integration of multiple technology standards, overlapping workforces, cultural diversity and regulatory issues that must be dealt with across state and international jurisdictions[91]. It is particularly vital to secure a certain independency of auditors to ensure auditing quality, which affects the accuracy of financial results, risk assessment and so on.

Employees

There are important stakeholders in the firm, such as critical employees, who care about its future even if the CEO has short horizons and is self-interested and shareholders are dispersed and powerless. Management depends upon employees to fulfill the productive purpose and strategic intentions of the company. As a consequence, particularly when experiencing large changes such as international merge and acquisition, the voice from employees should be taken into account. Although they do not have explicit control, they might express themselves through withdrawing their contributions to the firm or performing not so well, which may erode the anticipated synergy; weaken the company's market power, even lead to the failure of M&A finally. Letting employees own the company' shares seems a good way to align employees' interests with the company's, which has already been applied by many companies.

Executive compensation structure

An intellectual executive compensation structure would substantially reduce the

[91] Lloyd Karole & Fanning Jim, "The Audit Committee in the Age of Risk", Financial Executive; Mar 2007; 23,2; ABI?INFORM Global pg.54

conflicts of interest between owners and managers[92]. It is suggested to toughen pay-for performance metrics[93]. However, in recent years, performance is again moving to market-based measures, which encourage executives to pursue short-term profit goals even at the cost of companies' future survival and potential success. There is evidence in Chapter 5, once international M&A deals were complemented, and the CEO of the target company could receive an amount of money which sometimes is rarely large.

6.1.3 Managerial overconfidence

It is found that high-order acquisitions are associated with lower wealth effects than low-order acquisitions. That is, managers tend to credit the initial success to their own ability and therefore become overconfident and engage in more deals[94].

Since a merger results in replacing the managers of the target with the managers of the acquirer, the latter are likely to suffer from greater illusion of control over the prospects of the merger and to underestimate the probability of failure. In the M&A activities, overconfidence is often displayed in two forms: first, a corporate manager may overestimate the synergy gains of the potential merger. During the DaimlerChrysler case, the CEO Schrempp told shareholders to "expect the extraordinary", whereas, the large loss happened during recent years has showed that his grand scheme has proved extraordinary. Second, a manager may overestimate the value of his current company. That is, he may believe that the company's equity is undervalued.

As demonstrated in previous empirical case studies, failures to address cultural differences and inadequate strategic planning or implementation are often cited as

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[92] Weston & Mitchell &Mulherin, "Takeovers, Restructuring, and Corporate Governance"; Pearson Educational International , 4th Edition, pg572.
[93] Ettorre Barbara, "The Board in Crisis",The Corporate Governance Advisor, January/February 2009; 17:1; pg12.
[94] Doukas John A. & Petmezas Dimitris, "Acquisitions, Overconfident Managers and Self-attribution Bias", Europe Financial Management; 13:3; 2007; pg 531-577

common reasons why cross-border business combinations fail[95]. One reason why managers did not attach importance to post-merger integration planning is managerial overconfidence, which causes people to overestimate their knowledge, underestimate risks, and exaggerate their ability to control events.

As a consequence, in cross-border M&A, the problems managers faced are more complex, Manager should not perform just depending on his own experience and knowledge. The manner of a manager can be deeply influenced by domestic governance system, economic environment which are very distinguished from other countries. Therefore, the supervisory third party needs to monitor the valuation progress, and motivate the manager to take those external factors into overall strategy.

Hence, overcome managerial overconfidence is important in cross-border M&A, which may affect shareholders' interests seriously.

6.1.4 Shareholders

A recent survey of corporate directors found that almost 62 percent agreed with a statement, "On balance, M&A destroy more value than they create." There are numerous examples of mergers that have gone very badly and an aggregate wealth loss of $ 240billion for acquiring firm shareholders from mergers during 1998 to 2001[96]. In order to get owners' money worth, there are some issues needed to be dealt with:

<u>(1) More communication with different shareholders</u>

With regard to international M&A, some are proposed in order to prevent companies' short-term crisis such as financial loss, profit threat, cash flows; while some are acted

[95] Johnson Keith L. & Richson Cynthis L., "The Global M&A Boom Continues: Are Boards Getting Shareholders Their Money's Worth? , The Corporate Governance Advisor; Sep/Oct 2007; 15,5;ABI/INFORM Global pg.25
[96] Johnson Keith L. & Richson Cynthis L., "The Global M&A Boom Continues: Are Boards Getting Shareholders Their Money's Worth? , The Corporate Governance Advisor; Sep/Oct 2007; 15,5;ABI/INFORM Global pg.25

considering companies' long-term development strategy such as selling products into global markets, seeking more market share. Based on shareholder primacy principle, it is important to balance the relationship between short-term and long-term goals. Moreover, due to shareholders' different interests, they prefer the company to perform in their own interests. Therefore, for example, they might exaggerate the potential synergy in order to affect the decision-makers to take M&A, which may meet those shareholders' interests. As a consequence, more communication with different shareholders is needed for managers in order to make a right decision in the end.

(2) Go transparency

Clear communication and adequate information are vitally important for shareholders. Especially in cross-border M&A activities, due to different information disclosure degrees in different countries, for shareholders, it seems difficult to follow the course of M&A exactly and closely. Going transparency is the trend when conducting international M&A to meet the information needs from both parties, at the same time, to supervise companies' behavior broadly in order to ensure doing right decisions.

6.1.5 Organizational culture differences

According to Smircich (1983), on the one hand, culture is viewed as a variable, which is the normative "glue" of an organization influencing organizational members' attitudes and beliefs. Culture determines how the organization operates and ultimately drives its overall performance and ability to create sustainable success[97]. As a result of the characteristics of cultural dynamics and cultural variety, changing organizational culture is seen as very difficult; in some instances culture is even seen as beyond managerial control.

Change of executive board or leadership which often happened after mergers and

[97] Leadership Advantage , Culture Change , 11th May ,2009
http://www.leadershipadvantage.com/organizationperformance/culturechange.html

acquisitions, is another trigger that results in the organizational culture changes. Many studies have proved that different styles of leaderships generated different images on its stock performance and concerns on employees.

Moreover, regarding cross-border M&A, there always involves companies who own totally different internal organizational culture. Culture clash post-merger may erode the anticipated synergy savings and possibly incurred some severer problems, which finally result in the failure of cross-border M&A activities. Consequently, managers should recognize this kind of differences in organizational culture among M&A participant companies and take into account when making decisions.

6.2 External governance

External governance emphasizes on external legal and economic environment and external stakeholders, such as bidder's and target's country cultures, regulations, interests of external stakeholders, and public pressures from both original countries; and the conflicts among each. M&A theory in chapter 3 are applied as fundamental idea of the structure.

6.2.1 Stock market

The intuitional response of stock market is seen as a significant way of external governance. Almost every M&A activities, even not really happened only a rumor or an announcement related to possible M&A, can induce the fluctuation of stock price of participant companies.

A number of earlier studies found significant positive price effects of changes in top management. Some found insignificant price reactions[98]. The pressure of external corporate control markets usually stimulates companies to perform toward potential

[98] Weston &Mitchell et al ," Takeover, Restructuring, and Corporate Governance", Pearson Educational International, 4th Edition. Pg 575.

higher stock price, for example, to change managers or CEOs. In fact, the reaction of stock market is a signal which expresses the wider stakeholders' preference. In addition, financial crisis also could incur the fluctuation of stock price, which seems particularly significant during these days.

6.2.2 Country norms and value:

M&A project is always complex and involves different parties coming to the table. With their own unique natures and behavior patterns, culture is the outcome of project's as well. This is the pre-condition which is applied to all cross-border M&A activities. Both bidder and target firms may seek for synergies, increased market power, and stronger control on penetration; however, culture plays an important role for them approaching the domestic market.

Therefore, in cross-border M&A, bidder should acknowledge the target's host country's culture, such as value and ethics that will determine the nature of a corporate management style, governance and communication custom, and decision makers' interests and behavior etc.

6.2.3 Corporate governance systems

According to our analysis in Chapter 3, the patterns of M&A activities vary from country to country, which lurks interfere or divaricator among different parties. In addition, as theoretical evidence provided in Chapter 4, numbers of countries, shareholdings being dispersed across a range of financial intermediaries and a well-developed market for corporate control goes hand-in-hand with unspecific legal terms regarding employee rights in M&A; while other countries present more stability in ownership and less of a market for corporate control employee rights tend to be stronger. In the case study of Vodafone-Mannesmann Merger, this issue is the major conflict raised during the procedure of the merger. Therefore, as a prerequisite of a

cross-border M&A approval, corporations cannot just implement pure restructuring techniques, but they are required to acknowledge the other firm's corporate governance system base and coordinate its strategy to favor the interest of domestic parties, in order to avoid a culture clash among different corporate governance systems.

6.2.4 Government legislation and regulations

Corporate governance and related government regulations issues are of top concern for corporate executives. A countries' legislation and regulations, such as corporate governance code, company law, Accounting principle, Audit law and regulations, labor law, should be realized by FID investors.

In poor investor protection countries, corporations may have dominant insiders with such as nontrivial cash flow rights and large private benefits in the firms that they control. Their high exposure, such as high bargaining power of labor unions, interventionist government, may lead them to be conservative in directing corporate investment. Second, government often prefer conservative corporate investment and reserve much power on constraining value-enhancing corporate risk-taking to protect their interests, which may influence investment policy for their own benefit. In some countries, regulations also protect the domestic market and firms from enormous market control of foreign investors. According to the evidence showed in Vodafone-Mannesmann Merger and Danone in China cases study, influence of government legislation and regulations in cross-border M&A is significantly favorable for domestic stakeholders.

Those regulations will not only protect shareholders of the firms in the host country's and related stakeholders, but also determines the level of riskiness that investors will be undertaking in cross-border M&A. In order to eliminate the riskiness, cross-border M&A should be constructed or adjusted in compliance with the host countries'

regulations.

6.2.5 Interest of external stakeholders

External stakeholder has the same feature as internal stakeholders, yet with no voting or decision making right affiliated. In the empirical evidence showed in Vodafone-Mannesmann merger, the government and public pressure play an important role in the deal. From the research on Danone and Pepsi M&A speculation, the reactions of government and other public groups on this rumor had already opposed deal before the any official announcement.

Therefore, as the development of the international economy and increasingly intense competition, the power of stakeholders, such as creditors, customers, suppliers, special interest group and the community, is identical with internal stakeholders in decision making progress.

Creditors, suppliers and customers are the key groups determining the M&A synergies, while government and communities could eliminate the synergies if they are opposite of the deal. Corporations can reach market power and control of penetration if they could approach these stakeholders.

- **Creditors** dominate the company's ability to repay their debts, thus corporate governance is required to be restrict regulated to avoid scandals ensure its financial flexibility in cross-border M&A in order to maintain the confidence of these providers
- **Customers**' opinions of M&A though are merely subjective opinions; customers typically have their own motives and behaviors and may use merger investigations to obtain "sweetheart deals" from their suppliers. As a result of these, in progress of cross-border M&A, the external governance should shore up confidence of customers that M&A will not change or dilute the consistency in their benefits and interests.

- **Supplier** needs be paid in a timely fashion for the goods and services they supplied. They are interested in the continuance of the company treat their suppliers with understanding and ensure that they settle their debts on time to maintain the confidence of these providers. Therefore, corporate external governance should ensure supplier with sufficient solvency and sustaining cash flow performance.
- **Community** stake is in the companies which operate in their region. They are in the interest of sustained employment levels and welfare, and act in an environmentally friendly way. However, as an social group, community does have power to impact foreign investor on approaching local human resource. As a consequence, corporations need to be aware that if they are sufficient in harmonizing or balancing the conflicts between the corporation stawdship policy and the interest of community.
- **Government** holds stake in ensuring the companies act in a socially responsible way taking account of socially, ethical and environmental considerations, and analyzing corporate trends for various purposes such as employment levels, monetary policy, and market supply and demand of goods and services. It look at various aspects to do with fiscal policy such as capital allowances, incentives for investing in various industries or various parts of the country, and of course the taxation raised from companies. Since government could be the final decision maker of a cross-border M&A in some countries, interests of domestic government and its regulations should be acknowledged in advance,

6.2.6 Media function and public pressure

Media is on the front line in disseminating impartial news for ethical activities, transparency and accountability of corporations, and deliver those information to the market. Their public discussions that media creates will influence the public opinion from customer groups, suppliers groups, creditor groups and other external stakeholders.

According to case study of Danone in China and Danone and Pepsi merger, corporation who are undertaking an cross-border M&A may have a risk of challenging public ideas and society of the host country, and it will determine whether the deal can be successfully accomplished. However, no management prefers to be perceived as a destroyer of the social and economic environments, non-contributor to social causes, primarily a user of social services, etc. Instead, the management should govern itself on its activities, in order to convince the society to perceive the corporation and its activities as a "responsible citizen" and will not harm the interests and benefits of the domestic parties. And Communication between media and corporate bodies through efficient public relations can be vital to ensure sufficient governance and public ideas.

6.3 Summary

Both internal and external governance should be given the same level of attention for companies who engage into cross-border M&A activities. As to the internal governance dimension, the relationship between short-term gains and long-term wealth, internal self-regulation mechanism and internal organizational culture are advised for M&A companies to well balance, enhance and recognize. In addition, managerial overconfidence is one problem that should be overcame especially in the high risk cross-border M&A. In one word, to get shareholders' money worth is the goal of companies' behaviors. On the other side, external governance dimensions emphasis on both the bidder's and target's country cultures, regulations, interests of external stakeholders, and public pressures from both original countries. Both internal and external governance are very important to the success of an international business M&A transaction. In fact, it is impossible for us to cover all aspects and build up a totally comprehensive framework from corporate governance perspectives. We just try to construct a theoretical framework, based on previous theory and empirical case

studies in Chapter 3, 4 and 5, which may be considered as a reference when people conducting international M&A activities.

Chapter 7 Empirical test of framework

This chapter will test and provide new evidence or findings by a "on-progress" M&A in China, Beijing Huiyuan Beverage and Food Group Co. and Coca-cola company, in order to refine the framework produced in Chapter 6 to accomplish our study.

Beginning with a company profile and history of the deal, readers will understand the motives that Coca-Cola's intention of this deal. However, conflicts rose since Huiyuan's announcement in September 2008, and public voice also holds different opinion on this ever largest M&A in China. We will analysis the rationale of conflicts in this M&A deal from a corporate governance perspective in respect of all components selected. New findings are explored in the end of this Chapter, which will be process to next Chapter to refine this framework.

7.1 The two companies

7.1.1 Huiyuan

Beijing Huiyuan Beverage and Food Group Co., Ltd. was founded in 1992. It is a large and modern group company engaged in producing and marketing fruit and vegetable juice and juice drinks in China with a competent leading position. According to the latest data from AC Nielson, Huiyuan Juice has taken 46% of the pure juice market share, 39.8% of the nectar market share, and 10% of the fruit and vegetable juice market[99]. It also controls more than a tenth of the Chinese fruit and

[99] , Introduction of Huiyuan Group, China Huiyuan Juice Group Announces 2008 Annual Results http://www.huiyuan.com.cn/en/about/

vegetable juice market that grew 15 percent last year to $2 billion.[100]

7.1.2 Coca-Cola Company

The Coca-Cola Company is the world's largest beverage company, refreshing consumers with more than 450 sparkling and still brands. Along with Coca-Cola, recognized as the world's most valuable brand, the Company's portfolio includes 12 other billion dollar brands.

Cocla-Cola's penetration in China

The Coca-Cola business in China has been operating since 1979 and is well known for its sparkling beverage brands such as Coca-Cola, Sprite and Fanta. Coca-Cola already claims over half of China's soft drink market, and around a 10% share in the fruit and vegetable juice market, but has yet to make inroads selling pure juice.[101] In the last few years, the Company has also introduced a number of still beverage brands, including Guo Li Cheng (Minute Maid Pulpy) and Yuan Ye (Original Leaf Tea), with the objective of offering consumers a wide range of beverage choices. In line with this, the Company is seeking to further develop its beverage business through this acquisition.

China's fruit and vegetable juice market grew at a tempting 15% rate last year to US$2 billion, even as global demand for carbonated drinks fell. From Coca-Cola's perspective, and buying Huiyuan was a chance to penetrate China's seductive fruit and vegetable juice segment, in keeping with its global strategy of diversifying beyond its traditional carbonated drinks stronghold.

[100] Ding Qingfen, Diao Ying (2009), Coke bid for juice maker turns sour, China Daily
[101] Ding Qingfen, Diao Ying (2009), Coke bid for juice maker turns sour, China Daily

7.2 History of the deal

7.2.1 Timeline of events

- 3rd September 2008, Coca-Cola offered to buy Huiyuan, the nation's largest juice maker, for $2.4 billion in cash.
- 8th September 2008, a group of domestic soft drink makers sought to submit a proposal to the Chinese Ministry of Commerce in a bid to block the takeover.
- 2nd December 2008, Coca-Cola and Huiyuan jointed announced that the Chinese Ministry of Commerce had begun its anti-trust review, which would continue until 23rd March, 2009.
- 18th March 2009, China's Chinese Ministry of Commerce announced that Coca-Cola's bid to acquire China Huiyuan Juice Group failed to meet the country's anti-monopoly law.
- 18th March 2009, Coca-Cola Company and Huiyuan Juice Group said that they respect the decision of the Chinese Ministry of Commerce.

7.2.2 Before the announcement of Chinese Ministry of Commerce

Huiyuan Announcement of Coca-Cola's takeover

On September 3, 2008, China Huiyuan Juice Group Limited ("Huiyuan"; Hong Kong stock code: 1886) announced The Coca-Cola Company's ("Coca-Cola") intention to make a voluntary general offer to purchase all of the issued shares in the capital of Huiyuan, all of its outstanding convertible bonds, and for the cancellation of all its outstanding options ("the Offers"). The making of the Offers is subject to pre-conditions relating to Chinese regulatory approvals.[102]

[102] China Huiyuan Juice Group Announces Possible Voluntary Conditional Cash Offers by The Coca-Cola Company http://www.huiyuan.com.cn/huiinvestor/investor_en/detail.jsp?id=146

Chinese Ministry of Commerce Anti-trust Investigation on Coca-Cola

Coca-Cola applied anti-trust investigation to the Chinese Ministry of Commerce in September 2008. The Chinese Ministry of Commerce officially launched the investigation on November 11th to determine whether the acquisition of Huiyuan would harm other rivals and consumers rights or hamper technological development.

Public voice on this deal

Soon, the deal had been plagued by objections couched in nationalist rhetoric, and a poll by Sina.com found that over two-thirds of the 120,000 respondents disapproved of foreign investments in Chinese companies, about eighty percent supported Chinese Ministry of Commerce's rejection of the bid.[103]

7.2.3 Announcement of Chinese Ministry of Commerce

On March 18, 2009, the Chinese Ministry of Commerce rejected Coca-Cola's (KO.N) $2.4 billion bid for China's top juice maker, Huiyuan Juice. This became the first offer rejected since China's Anti-Monopoly Law took effect August 2008. As demonstrated in the statement from the Chinese Ministry of Commerce "this proposal would have an unfavorable impact on competition" and "The Chinese Anti-Monopoly Law review is meant to protect fair market competition and guard the interests of consumers and the public"[104]

The Chinese Ministry of Commerce states on its Web site that the investigation, which "exactly followed relative laws and regulations," found the transaction may disturb market competition. "If the acquisition of Huiyuan went into effect, Coca-Cola is very likely to take a dominating position in the domestic market and the consumers may have to accept the high price fixed by the company as they don't have more

[103] Public voting on Huiyuan and Coca-cola deal, http://finance.sina.com.cn/focus/huiyuan_2009/index.shtml
[104] REFILE-TEXT-China's statement on rejecting Coke's Huiyuan bid, 18 March 2009 http://www.reuters.com/article/companyNews/idUKPEK259020090318?symbol=1886.HK

choices"[105]

7.2.4 After the announcement of Chinese Ministry of Commerce

Response of both companies

On the same day, Coca-Cola Company and Huiyuan Juice Group said Wednesday that they respect the decision of the Chinese Ministry of Commerce to reject Coca-Cola's 2.3 billion U.S. dollar bid for China's largest juice maker. "Huiyuan respects the decision made by the Chinese Ministry of Commerce. The group's production is normal for the time being," the group said in a statement to Xinhuanet[106]. "Huiyuan will continue providing high-quality, safe and nutritious products to consumers." The Coca-Cola Company said in a statement to media that, "We are disappointed, but we also respect the Chinese Ministry of Commerce's decision."

Stock market reaction

Stocks in Huiyuan dropped 40% the day after the decision was announced, but even before that there were signs of trouble.

7.3 Analysis based on components in framework

It would have been a corporate integration made by god: A leading Chinese juice maker, having courted many suitors, finally found a willing partner who is the world's largest soft drink manufacturer. For the owners and CEO of the Chinese company Zhu Xinli, it would mean tremendous billion-dollar compensation. On the other hand, the bidder, Coca-Cola Company, would buy its way into a fast-growing and potentially vast market segment that it had so far failed to conquer. However, nature of different corporate governance systems, pressure from public voice, restrictions of Chinese

[105] Chinese Ministry of Commerce's announcement on Coca-Cola's acquisation of Huiyuan, 18th March 2009, http://www.mofcom.gov.cn/aarticle/b/c/200903/20090306108617.html
[106] Coca-Cola, juice maker Huiyuan both "respect" Chinese gov't rejection of purchase bid (19th March 2009), Xinhuanet, http://news.xinhuanet.com/english/2009-03/19/content_11032929.htm

regulation, and the dissenting opinion of competitors have negative impact on this proposed deal. There were two obstacles that Coca-Cola faced, one is the large size of the two companies, which will raise concerns about monopolies, and the second is that the brand of Huiyuan is considered to be protected as a famous domestic brand. In following sections, we will analysis the corporate governance problems raised in this failed M&A based on the constructed framework in Chapter 6.

7.3.1 Internal governance

Hypothesis 1: Coca-Cola's directors are very sensitive to potential increased risks, instead of only complying with the management.

When MOC announced to reject the Huiyuan bidder from Coca-Cola, Coca-Cola's response of respecting Chinese Authority's decision, to some extents, indicates the possibility of the previous rumor that there are more and more opposition voices from the board of Coca-Cola, especially during the tough financial crisis. From this point of view, the block of Chinese MOC is just an opportunity for Coca-Cola to get away from the multinational M&A deal, which might be the desire of these "more and more directors" who did not support to acquire Huiyuan Juice Group from the beginning. The behavior of Coca-Cola, although the company never admit and always announced to the public that board of directors in Coca-Cola would give full support to acquire Huiyuan and extend its non-carbonated drinks market in China, implied that directors of this soft drink giant are very sensitive to the company's possible negative trends and potential increased risks and keep alert to the firm's future development, instead of solely complying with the top management. We think maybe that is one reason Coca-Cola can survive and succeed over past decades.

Hypothesis 2: It is impossible for any CEO to make a decision totally ignoring or against employees' interests, so is in Huiyuan.

Huiyuan's CEO Mr. Zhu Xinli had spoken to the public media that the decision of selling Huiyuan to the largest soft drink producer is in fact due to the consideration of the interests of shareholders and numerous employees in Huiyuan. In Huiyuan, employees are encouraged to participant in all kinds of innovation and creation activities. A friendly relationship is encouraged to establish and maintain with employees. The attitudes of the employees towards M&A issues sometimes are decisive to the final result. It is impossible for any CEO to make a decision totally ignoring or against employees' interests, so is in Huiyuan.

Hypothesis 3: In Coca-Cola' proposed takeover of Huiyuan, Coca-Cola may overestimate the synergy gains and offer a much high price, due to the coming of financial crisis.

Coca-Cola's bidder of $2.4 billion to purchase Huiyuan is such a good price for the target, which is about 3 times as Huiyuan's market value at that moment. Nevertheless, as one of Coca-Cola's executives said that, 'due to the coming of economic crisis, Huiyuan's stock price dropped by approximately 25%, therefore, Coca-Cola is facing large pressure actually.' although Coca-Cola announced to the public that they would not change the bidder price. In Coca-Cola's proposed takeover of Huiyuan, the price of $2.4 billion is really very attractive to the Chinese Juice maker, but it also demonstrated that Coca-Cola may overestimate the synergy gains of the potential merger according to the pressure which the American company might face. We think maybe that is one important reason why Coca-Cola did not response actively to the MOC's decision like Vodafone acquiring Mannesmann. Managerial overconfidence often results in a too- high bidder based on overestimating synergy in future.

In the event of Coca-Cola's proposed takeover of Huiyuan, through some statements on the possible benefits once the deal came true, it is found that they have primary integration plan and implementation strategy for the future after merger. However, according to Coca-Cola's negative response to Chinese MOC, we can suppose that Coca-Cola might not be prepared well for the future.

Hypothesis 4: More communication with the company's different shareholders seems very necessary in Huiyuan, due to different interests among shareholders.

Coca-Cola's offer has received support from more than 60 percent of Huiyuan's shareholders until December, 2008[107]. According to Huiyuan's ownership structure, Danone Group together with other PE funds (Holand Bank and Warburg Pincus Private Equity, etc.) own about 44% shares, compared to 41% of Mr. Zhu, it is found that the power of control is in foreign owners' hands to some extents. It is clear that France Danone and other PE funds are always interested in getting more returns on their investments in short time, disregarding the company's long-term overall development plan. Therefore, for the managers in Huiyuan, to balance the relationship between short-term and long-term goals, more communication with the company's different shareholders seems vital important. Indeed, adequate information disclosure is the precondition for shareholders to discuss with managers. Going transparency is necessary for both parties in order to communicate equally and conveniently.

Hypothesis 5: It is not sure that there won't have culture clash in the combined company, owing to the organizational culture differences between Coca-Cola and Huiyuan.

The Coca-Cola Company is the world's largest beverage company, refreshing consumers with nearly 500 sparkling and still brands. Through the world's largest

[107] People's Daily Online: http://english.peopledaily.com.cn/90001/90776/90884/6545019.html (2009-5-20)

beverage distribution system, consumers in more than 200 countries enjoy the Company's beverages at a rate of nearly 1.6 billion servings a day. Huiyuan is one of the most successful national brands in China, which has taken 46% of the pure juice market share of China. There must have differences on organizational culture between these two companies. Huiyuan is more localized to Chinese consumers although Huiyuan's juice concentrates, purees and juice products have been exported to over 30 countries and regions[108], while Coca-Cola is more internationalized and has a much stronger market power in the world. There might have controversy in corporate visions, values or behavior manners and so on. It is not sure that after merger there won't have culture clash, which may erode the anticipated synergy savings.

7.3.2 External governance

Hypothesis 1: In Coca-Cola' proposed takeover of Huiyuan, Huiyuan's stock price is affected a lot, which demonstrates the efficiency of stock market control.

For the initial public offering last year, Huiyuan stock was set at HK$ 6. Since then, the price surged to a peak of HK$ 12 per share but started slumping this year. By the time trading in the stock was suspended in advance of the Coca-Cola sale announcement, Huiyuan's share price had slipped to HK$ 4[109].

China's Ministry of Commerce (MOC) announced Wednesday morning that Coca-Cola's bid to acquire China Huiyuan Juice Group failed to meet the country's anti-monopoly law. Huiyuan's shares on the Hong Kong stock market were down nearly 20 percent[110] before being suspended Wednesday.

The fluctuation of share price could be seen as a signal of corporate performance. The reaction of stock market, as a sensitive and effective external governance control

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[108] Huiyuan 's homepage http://www.huiyuan.com.cn/en/about/index.html
[109] Huiyuan 's Calculated Deal with Coca-Cola, Caijing Magazine, 18th September, 2008 http://english.caijing.com.cn/2008-09-18/110013755.html
[110] Coca-Cola, Juice maker Huiyuan both "respect" Chinese Gov't rejection of purchase bid, 19th, March 2009, http://news.xinhuanet.com/english/2009-03/19/content_11032929.htm

mechanism, has been attracting people's lot of attention. Huiyuan's stock price changes reflected the situation the company is in now and the prospect of the Chinese top juice maker.

Hypothesis 2: In Coca-Cola' proposed takeover of Huiyuan, Coca-Cola acknowledges country norms and value

Up to this year, Coca-Cola has been living in China for 30 years with its success over past decades, and China also became one of its largest markets in the world. This not only because of its unique beverage products, but more significantly attribute to its localization strategy in China. And this can be proved by its branding in China.

Coca Cola, found prior to the launch of their localized brand identity that shopkeepers had made their own signage, approximating the phonetics of the name as best they could. The company employed its own localization team of groups of experts in this area, and defined its branding strategy in China in compliance with overall corporate strategy. This team cleverly fused the transliteration and conceptual methods to come up with "ke kou ke le", which translates in Mandarin to "permitting the mouth to rejoice". Indeed, the concepts of this company and its products delivered to market are exactly identical to the Chinese culture.

In other word, Coca-cola successfully got rid of culture crash in approaching the Chinese market. This substantially built up a foundation for its further expansion in China. Therefore, Coca-cola well acknowledges the Chinese norms and value.

Hypothesis 3: In Coca-Cola' proposed takeover of Huiyuan, Coca-Cola Realize different corporate governance systems

As being one of the largest corporations in the United States, Coca-Cocla Company is best known for its flagship product Coca-Cola, invented by pharmacist John Stith

Pemberton in 1886. The Coca-Cola formula and brand was bought in 1889 by Asa Candler who incorporated The Coca-Cola Company in 1892.[111] With its more than hundred year history, Coca-cola is deeply rooted in **Anglo-Saxon corporate governance system** which is a market-oriented system serving as a mechanism for independent shareholders to influence managerial decision-making. Stock and bond markets play an important role but the Anglo-Saxon system is primarily characterized by the external market for corporate control, also named as the takeover market. As a result, high compensation is based on a high level of performance.

Beijing Huiyuan Beverage and Food Group Co., Ltd. is a large and modern group company engaged in producing and marketing fruit and vegetable juice and juice drinks, which is the leading beverage company in China. It was initially established as Shandong Zibo Huiyuan Company in 1992 by Mr. Zhu Xin Li in Shandong. Although Huiyuan has much international cooperation with FDI, it is rooted in **Asia Pacific Relationship-Based corporate governance system**. As Thomas Clarke pointed out that, "The countries of the Asia Pacific also have a cultural diversity with different political and legal structures, and social traditions. Not only does this make for significant national differences in corporate governance policy and practice, but many countries in Asia are still engaged in a process of institutional development. Most countries of the region have corporate governance system that are essentially based around close relationships, usually involving family control, and ongoing close relationships with creditors, suppliers, and the major customers. In some systems this is reinforced by close relations with regulators and state officials"[112]

In contrast to Anglo-Saxon corporate governance system, Chinese corporate governance has weaker investor protection, yet local firms and stakeholders are assigned with more protection. Local firms' dominant insiders with nontrivial cash

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[111] Coca-cola history, Coca-Cola timeline, Coca-Cola heritage, Coca-Cola Company official homepage: http://heritage.coca-cola.com/

[112] Clarke Thomas(2007) , International Corporate Governance, London and New York: Routledge, Chapter 6, Page 200

flow rights and large private benefits in the firms that they control. This comparably high exposure, such as high bargaining power of labor unions, interventionist government, public opinion and competitors may lead the deal to be conservative in directing governance and decisions in cross-border M&A. Moreover, Chinese government prefers conservative corporate investment and reserves much power on constraining value-enhancing corporate risk-taking to protect their interests and domestic market, which may influence investment policy for their own benefit.

Therefore, Coca-Cola employed its M&A strategy in order to maximize the value of shareholders, which is in compliance with Anglo-Saxon corporate governance system, however, have failed to realize the key drivers in Chinese corporate governance concerning the bargaining power of labor unions, interventionist government, public opinion and competitors.

Hypothesis 4: In Coca-Cola' proposed takeover of Huiyuan, Coca-Cola profoundly understand government legislation and regulations

Despite of company law and FID regulations in China, we have chosen the Anti-trust law for analysis. There are two reasons, firstly, Coca-Cola has been operating in China for 30 years with its profound understanding of traditional Chinese legislation and regulations; secondly, this proposed deal was rejected by Chinese Ministry of Commerce and there were no all legal progress implemented.

Coca-Cola Co.'s $2.4 billion offer to acquire China Huiyuan Juice Group Ltd. is the first major test of China's new antitrust law which took effect last one month before announcement and attempts to streamline and standardize the government's antitrust activities. Previously, there is no unifying law on the books, and several agencies had a say in matters of general competition and mergers in China. Because of this deal, it comes amid public concern over the loss of national brands.

In the announcement published on 18th March 2009, Chinese Ministry of Commerce declared that Coca-Cola's purchase of China's Huiyuan fails to pass antimonopoly review. Statements are following,

- First, if this deal proved, Coca-Cola will control approximately 60% market share carbonated market, since its control on carbonated market, especially in distribution network of the market, will be transferred to juice market. This will result in Coca-Cola' absolute monopoly in Chinese beverage market.
- Second, because Coca-Cola and Huiyuan are dominantly leading beverage brands in China, the integration of both will induce pressure and distress on new entrants to Chinese beverage market.
- Third, 100% of absolute stake control has negative impact on the development and innovations of small and medium sized firms, which can harm the Chinese industry going on sound progress and the interests of consumers.

Coca-Cola, has followed the regulations in China and proposed this deal to Chinese Ministry of Commerce. However, it did not make any efficient solutions and positive response on the rejection afterwards. Thus, Coca-cola's strategy on this deal was not well prepared for this new antitrust law. More importantly, in contrast to Vodafone's positive attempts after the rejection on its bid for Mannesmann, Coca-cola's conservative responses implies that there could have opposition from Coca-Cola's board on this deal from the beginning.

Hypothesis 5: In Coca-Cola' proposed takeover of Huiyuan, Coca-Cola Take care the interest of external stakeholders

As the development of the international economy and increasingly intense competition, the stakeholders, such as creditors, customers, suppliers, special interest group and the community, have the same bargaining power as internal stakeholders in decision making progress. In Coca-Cola and Huiyuan's deal, public pressure have

influenced the progress, and its external stakeholders might be within the public groups that holds different anxious or opinions on this deal.

- **Creditors** who dominates the company's ability to repay their debts, This deal is worth $2.4 billion US dollar in cash, which became the largest in Chinese M&A history and the second largest M&A in US. Because of the big change for both companies in a form of foreign invested M&A，Coca-Cola's creditors might have anxious about solvency of this buyout and financial performance of the integrated firm.
- **Customers**' opinions of M&A though are merely subjective opinions, customers typically have their own motives and behaviors and may use merger investigations to obtain "sweetheart deals" from their suppliers. Their opposition to mergers may be based more on fears about change or uncertainty. However, in China, customers would have a protectionism emotion on its favorite domestic brand against foreign ones.
- **Supplier** are interested in the continuance of the company treat their suppliers with understanding and ensure that they settle their debts on time to maintain the confidence of these providers. In contrast to customers and creditors, Coca-Cola and Huiyuan's deal might benefit suppliers. If the deal was implemented, the supply chain of both companies could be diversified and optimized, which can create more possibilities of cooperation.
- **Community** are in the interest of sustained employment levels and welfare, and act in an environmentally friendly way. In M&A, it is very often to see job-cutting and management layoff. Both Coca-Coca and Huiyuan are large-sized company, for optimization and stake control purposes, restructuring is inevitable. Communities have power to impact foreign investor on protection local labour rights. It is not surprised they hold oposit opinion on this cross-border M&A.
- **Government** holds stake in ensuring the companies act in a socially responsible way taking account of socially, ethical and environmental considerations, and analyzing corporate trends for various purposes such as employment levels, monetary policy, and market supply and demand of goods and services.

Coca-Cola and Huiyuan's deal was finally rejected of the new Chinese Antitrust law. Chinese government who was the final decision maker plays an important role. As discussed in previous section, in Asian Pacific corporate governance system government will control the interests from the market overall interests such as competition and antitrust. In order to reserve its interests, regulations and legislations are the tool of governments to protect its domestic market.

Coca-Cola is under Anglo-Saxon corporate governance system which mainly asserts shareholders value, while neglecting the stakeholder interests based Chinese corporate governance system. And it did not realize that the opposition from those external stakeholders will determine if the deal can be accomplished in China.

Hypothesis 6: In Coca-Cola' proposed takeover of Huiyuan, Coca-Cola is vigilant of media function and public pressure

As with past cross-border deals, government leaders will ultimately determine whether a deal goes through. They may face public pressure to keep a domestic brand in local hands. In China, as in other countries, this means that the final decision could be influenced by public opinion, which can in turn be driven behind the scenes by opponents of the deal. If the parties involved in the takeover were not able to managing public perceptions, the odds of obtaining a favorable result may likely be stacked against the deal.

On 3rd September 2008, The Wall Street Journal states that "Gauging public sentiment in China is difficult, but according to an online poll conducted by Chinese Web site Sina.com, 82% of more than 40,000 respondents oppose Coke's purchase of Huiyuan."[113] And on 8th of September 2008, a group of domestic soft drink makers sought to submit a proposal to the Chinese Ministry of Commerce in a bid to block the takeover.

[113] Rick Carew, Sky Canaves, Coke Deal To Test China's New Antitrust Law, The Wall Street Journal, September 5, 2008

Coca-Cola's takeover of Huiyuan has raised public opposition. It can be inferred that Chinese Ministry of Commerce has taken public opinion into consideration to torpedo a deal that might pose as a "destroyer" of the domestic market. With no positive response or communication to the media and public opposition, Coca-Cola was again conservative, and left the adjudication to Chinese Ministry of Commerce. Coca-Cola might have predicted pressure from the public and media, however, it did not realize the media function and public pressure can determine if the deal can be accomplished.

Chapter 8 A refined conceptual corporate governance framework in cross-border M&A

Following the analysis of Coca-Cola and Huiyuan by the conceptual framework of Chapter 6; we have five new findings of corporate governance problems besides the issues in the framework. To refine this conceptual framework, these five new findings will be supplemented.

8.1 New Findings from Coca-Cola and Huiyuan's deal

By presenting previous two sections, Coca-cola and Huiyuan's deal has been analyzed based on the framework in Chapter 6, and this framework has covered most evidence appeared in this case study. In addition to the corporate governance problems investigated in the framework, there are new findings emerged in this case study as well. In order to refine the framework in this chapter, those new findings are categorized into two groups, internal Governance and external Governance, in compliance with the structure of the framework in Chapter 6.

New finding 1: Self-interests of CEO

It is reported that Mr. Zhu Xinli will get 7.4biliion HK Dollars[114] if the transaction with Coca-Cola could be carried out. Accordingly, it is suspected that Mr. Zhu decided to accept the offer owing to pursuing his own interests for getting a large income package. Moreover, in this M&A matter, there was a rumor that considering such an old age, the CEO of the target company Huiyuan Mr. Zhu preferred to take a rest and get away from the large pressure from the outside. It is understood that the enterprisers are very hard and tired especially doing business in China, which has the most furious competition and the greatest stress among the world.

New finding 2: Competition

Competition is a new finding in Coca-Cola and Huiyuan's deal. As discussed in Chapter 3, competitiveness is the main driver in global economy as well as in M&A. The intention of Coca-Cola's takeover of Huiyuan is also aiming at maximizing shareholder value by enhancing competitive advantages, the main driver behind M&A, so is in cross-border.

In this case, Huiyuan has taken 46% of the pure juice market share, 39.8% of the nectar market share, and 10% of the fruit and vegetable juice market. Coca-Cola already claims over half of China's soft drink market, and around a 10% share in the fruit and vegetable juice market, but has yet to make inroads selling pure juice. If the deal was approved, the combined corporation would have generated great synergies financially and operationally. Resources, assets, supply chain and distribution channels can be consolidated and optimized. As a consequence, the Chinese beverage market probably is dominant by Coca-Cola and Huiyuan.

[114] China.com.cn, 9th September, http://www.china.com.cn/economic/txt/2008-09/09/content_16414617.htm
China Agriculture Information website, 15th October 2008, http://information.zgppny.com/info52302.shtml

The Chinese Ministry of Commerce also took this into consideration. As it declared in announcement, new Chinese Antitrust law will prevent Coca-Cola from its absolute monopoly in Chinese beverage market, protect new entrants to Chinese beverage market from pressure and distress induced by this takeover, and protect the interests and rights of medium and small-sized domestic juice firms.

Competitiveness is the pushing hand behind M&A; however, the Antitrust Law protects external stakeholders from emerged monopoly in unbalanced competition. Therefore, in cross-border M&A, corporations should not only seek competitiveness regardless the unfavorable impacts on relationship-based and stakeholder-concerned corporate governance systems. In case of unbalanced competition, regulations and public voice will induce protection the interest and right of local stakes, which might seriously block the M&A.

New finding 3: Competitors

Followed competition, competitors are taken account into external governance of the framework. As discussed in previous section competition is one of the aspects of macro-economics, however, the evidence in Coca-Cola and Huiyuan merger has showed that it affects the interests and relationship of external stakeholders, such as competitors. Since external stakeholders are one of the major stake groups in corporate governance, we include this aspect as a component of the interests of external stakeholders in the framework

As presented in the section of timeline of events of this case, on 8th September 2008, a group of domestic soft drink makers sought to submit a proposal to the Chinese Ministry of Commerce in a bid to block the takeover. Accompany with the public opposition, it can be inferred that competitors would use all available methods and resources, be it politicizing the nationalist sentiment, or lobbying with government authorities, to torpedo a deal that might pose a threat to their very own survival.

Interests of competitors play an important role in cross-border M&A, which might influence the opinion of the final decision maker, the government. Therefore, in relationship based or stakeholder based corporate governance countries, should adopt a coordinate strategy that acquire and control the target's stake slowly in stead of 100% at once.

New finding 4: Nationalism

The nationalism takes place both as resistance to foreign acquirers and as support for domestic ones. Cross-border M&A conflicts can be resulted from nationalism.

Corporate mergers and acquisitions are an important part of a market economy. Large firms often enter into a new market through acquisitions of local firms. If there is excess capacity in a sector, firms also often exit the economy not through bankruptcy but by being acquired by another firm.

In Coca-Cola and Huiyuan case, synergies would be huge if those to firms integrated. The combined group would have strong bargaining power in domestic market. The merger would create absolute control on supply chain and distribution channel which are inter-transferable between the two corporations. However, External stakeholders including government, communities and competitors may have nationalism and protectionism emotions on domestic economy. On the other hand, nationalists insists on keep the domestic firm in hands of Chinese, since Coca-Cola’s takeover with hundred percent of Huiyuan stake gets too much public attention.

Managing nationalism of the host country is an important prerequisite in cross-border M&A. Since it involves the emotions of major external stakeholders, corporations should take nationalism into consideration in advance to estimate the riskiness incurred by it. In addition, nationalism is not able to be eliminated in some countries,

so corporations should understand the reasons behind and adjust the M&A strategy to comfort domestic stakeholders. In our refined framework, nationalism will be taken into the external governance.

8.2 The refined conceptual corporate governance framework:

By combining the framework constructed in Chapter 6 and the new findings of corporate governance problems in Coca-Cola and Huiyuan case study, we refine the conceptual framework as following.

Figure 2 A refined conceptual corporate governance framework

Corporate Governance \ Merger and acquisition		Synergy	Market power	Control of penetration
Internal	Board of directors	**Problem**: Directors are always compliant with management, not properly take the oversight role.		
		Solution: Directors should remember to ask questions, be sensitive to the type of information that indicates increased risks or negative trends, track M&A activities of the company they are serving, seek multiple sources of information.		
	Internal self-regulation mechanism(Auditors, employees, executive compensation structure)	**Problem**: Audit quality affects the accuracy of financial results, risk assessment etc.; Employees if not perform well, will erode the anticipated synergy, weaken the market power, even lose competitiveness; A reasonless executive compensation structure will increase the conflicts of interests between owners and managers, negatively affect corporate performance which is related to market share, control of penetration etc.		
		Solution: Companies should enhance companies' internal self-regulation mechanism--independent auditors, employee-ownership, and maintain a sustaining friendly relationship with employees, toughen pay-for-performance metrics.		

	Managerial overconfidence	**Problem**: may overestimate the synergy gains of the potential merger.	**Problem**: inadequate post-merger planning causes M&A failures, bad performance, the decrease of market share, shrink international coverage etc.	**Problem**: managers always stay on the same level, may lead to the loss of competitive advantage as more and more entrants enter such contestable markets quickly.
		Solution: Managers should overcome overconfidence especially in high-risk cross-border M&A; board of directors should prevent and keep alert of managerial overconfidence.		
	Shareholders	**Problem:** shareholders' different interests, may exaggerate the potential synergy, impact the decision whether to M&A or not.		
		Solution: More communication with shareholders is needed for managers; the decision-making process going transparency is the trend to meet the information needs from shareholders.		
	organizational culture	**Problem:** culture clash in the combined company may erode the anticipated synergy savings.		
		Solution: Managers should recognize organizational culture differences and take into account when making decisions.		
	CEO	**Problem:** pursue his own interests, personal factors such as old age to retire.		
		Solution: Corporations should introduce an independent party or organization to supervise CEO.		
External	Country norms and value	**Problem**: pre-condition of generating synergy.	**Problem**: pre-condition of gaining market power.	**Problem**: pre-condition of controlling penetration.
		Solution: management should understand target's host country's culture, such as value and ethics that will determine the nature of a corporate management style, governance and communication custom, and decision makers' interests and behavior etc. to process the cross-border M&A smoothly.		
	Stock market	**Problem:** Almost every M&A activities even not really happened (rumors, news, announcement about possible M&A) would induce the fluctuation of stock price of participant companies, so would financial crisis.		
		Solution: Company participants should be aware of the reaction of stock market as corporations' external control.		
	corporate governance	**Problem**: pre-condition of cross-border M&A.		

<table>
<tr><td rowspan="11"></td><td>systems</td><td colspan="3">Solution: management should acknowledge the other firm’s corporate governance system base and coordinate its strategy to favor the interest of domestic parties, in order to avoid a culture clash among different corporate governance systems.</td></tr>
<tr><td rowspan="2">Government legislation and regulations</td><td colspan="3">Problem: prerequisite of cross-border M&A approval.</td></tr>
<tr><td colspan="3">Solution: cross-border M&A should be constructed or adjusted in compliance with the host countries’ regulations.</td></tr>
<tr><td rowspan="2">Interest of external stakeholders</td><td>Problem: external stakeholders' behaviors determine if M&A gains anticipated synergy.</td><td>Problem: entry barriers External stakeholders’ opposition might dilute the market power.</td><td>Problem: external stakeholders may fear of the change of integration, and conserved of their behaviors and decisions.</td></tr>
<tr><td>Solution: management should optimize the interests and benefits of customers, creditors and suppliers in M&A to save costs and increase market shares</td><td>Solution: management should employ product differentiation strategy and sustaining R&D to reach a dominant position in the market</td><td>Solution: management should build up confidences of external stakeholders and sustaining relationship with them.</td></tr>
<tr><td rowspan="2">Media function and public pressure</td><td colspan="3">Problem: pre-condition of cross-border M&A.</td></tr>
<tr><td colspan="3">Solution: management should communicate with the media and govern itself on its activities, in order to convince the society to perceive the corporation and its activities as a “responsible citizen” and will not harm the interests and benefits of the domestic parties.</td></tr>
<tr><td rowspan="2">Competition</td><td>Problem: enormous synergy will threat the growth of small and medium sized firms in the industry, which is restricted by regulations of some stakeholder-based corporate governance</td><td>Problem: dominant market share will magnify the control of market and induce unbalanced competition and monopoly.</td><td>Problem: unbalanced competition will threats the survival of the peers by dominating the distribution channel</td></tr>
<tr><td colspan="3">Solution: corporations should not only seek competitiveness regardless the unfavorable impacts on relationship-based and stakeholder-concerned corporate governance systems and consider</td></tr>
</table>

		the interest and right of local stakes, since Antitrust law might seriously block the M&A.
	Competitors (Competitor is a corporation's external stakeholder. Since it functions differently than other external stakeholders, this framework will present as an independent factor)	**Problem**: in relationship-based and stakeholder-concerned corporate governance countries, antitrust law will reject the M&A if there was a threat to the survival of the industry peers.
		Solution: In this kind of corporate governance, corporations should first follow the antitrust regulations and adopt a coordinate strategy that acquire and control the target's stake slowly in stead of 100% at once.
	Nationalism	**Problem**: prerequisite of cross-border M&A approval, and nationalism can induce the public voice and government intervention.
		Solution: corporations should take nationalism into consideration in advance to estimate the riskiness incurred by it. Nationalism is not able to be eliminated in some countries, so corporations should understand the reasons behind and adjust the M&A strategy to comfort domestic stakeholders.

Chapter 9 Conclusion

This paper began with a brief description of the event that on March 18, 2009, the Chinese Ministry of Commerce rejected the Coca-Cola Company’s $2.4 billion bid for China’s top juice maker, Huiyuan Juice Group. We chose to open with that topic because the Coca-Cola and Huiyuan matter is kind of similar with some merger cases happened during the recent merger wave, for example, Vodafone-Mannesmann, Daimler-Chrysler, Pepsi-Danone. No matter whether these multinational M&A activities succeed or not finally, we see that a common theme that they share is corporate governance. Good corporate governance is a key to the integration of corporations, financial institutions and markets, and central to the health of our

economies.

Successful multinational M&A are not easy, there are many factors needed to consider for participants in cross-border M&A transactions. In addition to traditional corporate governance factors, which mainly embody board of directors, managers and stakeholders and so on, some other factors such as country norms and value, government legislation and regulation, public pressure and media are also vital important for conducting a prosperous cross-border M&A business.

To answer this paper aim: a conceptual corporate governance framework about problems and solutions is constructed in conjunction with cross-border M&A. We try our best to make that framework more comprehensive and useful through reading a lot of previous literatures and studying some empirical cases. Due to the limitation of time, we engaged in investigating 5 major international M&A cases in total. By testing in Coca-Cola and Huiyuan deal, some new findings are added and a revised framework is set up for firms who are interested in or currently working on cross-border M&A activities.

There has been much discussion of corporate governance in public over the past decades. Much of this attention has been captured by many accounting scandals such as those that happened at Enron, WorldCom. This has led to changes in laws and accounting rules in order to achieve more accurate reporting of financial data to markets. However, there has been much less focus on changes in governance related to cross-border M&A. Given the recent M&A failures, a further research on this aspect of corporate governance could be helpful.

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Appendix

Figure 1 A conceptual corporate governance framework

<table>
<tr><td colspan="5">Figure 1 A conceptual corporate governance framework</td></tr>
<tr><td colspan="2">Merger and acquisition
Corporate Governance</td><td>Synergy</td><td>Market power</td><td>Control of penetration</td></tr>
<tr><td rowspan="7">Internal</td><td rowspan="2">Board of directors</td><td colspan="3">Problem: Directors are always compliant with management, not properly take the oversight role.</td></tr>
<tr><td colspan="3">Solution: Directors should remember to ask questions, be sensitive to the type of information that indicates increased risks or negative trends, track M&A activities of the company they are serving, seek multiple sources of information.</td></tr>
<tr><td rowspan="2">Internal self-regulation mechanism(Auditors, employees, executive compensation structure)</td><td colspan="3">Problem: Audit quality affects the accuracy of financial results, risk assessment etc.; Employees if not perform well, will erode the anticipated synergy, weaken the market power, even lose competitiveness; A reasonless executive compensation structure will increase the conflicts of interests between owners and managers, negatively affect corporate performance which is related to market share, control of penetration etc.</td></tr>
<tr><td colspan="3">Solution: Companies should enhance companies' internal self-regulation mechanism--independent auditors, employee-ownership, and maintain a sustaining friendly relationship with employees, toughen pay-for-performance metrics.</td></tr>
<tr><td rowspan="2">Managerial overconfidence</td><td>Problem: may overestimate the synergy gains of the potential merger.</td><td>Problem: inadequate post-merger planning causes M&A failures, bad performance, the decrease of market share, shrink international coverage etc.</td><td>Problem: managers always stay on the same level, may lead to the loss of competitive advantage as more and more entrants enter such contestable markets quickly.</td></tr>
<tr><td colspan="3">Solution: Managers should overcome overconfidence especially in high-risk cross-border M&A; board of directors should prevent and keep alert of managerial overconfidence.</td></tr>
<tr><td>Shareholders</td><td colspan="3">Problem: shareholders' different interests, may exaggerate the potential synergy, impact the decision whether to M&A or not.</td></tr>
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<table>
<tr><td rowspan="3"></td><td></td><td colspan="3">Solution: More communication with shareholders is needed for managers; the decision-making process going transparency is the trend to meet the information needs from shareholders.</td></tr>
<tr><td rowspan="2">organizational culture</td><td colspan="3">Problem: culture clash in the combined company may erode the anticipated synergy savings.</td></tr>
<tr><td colspan="3">Solution: Managers should recognize organizational culture differences and take into account when making decisions.</td></tr>
<tr><td rowspan="9">External</td><td rowspan="2">Country norms and value</td><td>Problem: pre-condition of generating synergy.</td><td>Problem: pre-condition of gaining market power.</td><td>Problem: pre-condition of controlling penetration.</td></tr>
<tr><td colspan="3">Solution: management should understand target’s host country’s culture, such as value and ethics that will determine the nature of a corporate management style, governance and communication custom, and decision makers’ interests and behavior etc. to process the cross-border M&A smoothly.</td></tr>
<tr><td rowspan="2">Stock market</td><td colspan="3">Problem: Almost every M&A activities even not really happened (rumors, news, announcement about possible M&A) would induce the fluctuation of stock price of participant companies, so would financial crisis.</td></tr>
<tr><td colspan="3">Solution: Company participants should be aware of the reaction of stock market as corporations' external control.</td></tr>
<tr><td rowspan="2">corporate governance systems</td><td colspan="3">Problem: pre-condition of cross-border M&A.</td></tr>
<tr><td colspan="3">Solution: management should acknowledge the other firm’s corporate governance system base and coordinate its strategy to favor the interest of domestic parties, in order to avoid a culture clash among different corporate governance systems.</td></tr>
<tr><td rowspan="2">Government legislation and regulations</td><td colspan="3">Problem: prerequisite of cross-border M&A approval.</td></tr>
<tr><td colspan="3">Solution: cross-border M&A should be constructed or adjusted in compliance with the host countries’ regulations.</td></tr>
<tr><td>Interest of external stakeholders</td><td>Problem: external stakeholders' behaviors determine if M&A gains anticipated synergy.</td><td>Problem: entry barriers External stakeholders’ opposition might dilute the market power.</td><td>Problem: external stakeholders may fear of the change of integration, and conserved of their behaviors and decisions.</td></tr>
</table>

		Solution: management should optimize the interests and benefits of customers, creditors and suppliers in M&A to save costs and increase market shares	**Solution**: management should employ product differentiation strategy and sustaining R&D to reach a dominant position in the market	**Solution**: management should build up confidences of external stakeholders and sustaining relationship with them.
	Media function and public pressure	**Problem**: pre-condition of cross-border M&A.		
		Solution: management should communicate with the media and govern itself on its activities, in order to convince the society to perceive the corporation and its activities as a "responsible citizen" and will not harm the interests and benefits of the domestic parties.		

Figure 2 A refined conceptual corporate governance framework

Figure 2 A refined conceptual corporate governance framework				
Corporate Governance \ Merger and acquisition		Synergy	Market power	Control of penetration
Internal	Board of directors	**Problem**: Directors are always compliant with management, not properly take the oversight role.		
		Solution: Directors should remember to ask questions, be sensitive to the type of information that indicates increased risks or negative trends, track M&A activities of the company they are serving, seek multiple sources of information.		
	Internal self-regulation mechanism(Auditors, employees, executive compensation structure)	**Problem**: Audit quality affects the accuracy of financial results, risk assessment etc.; Employees if not perform well, will erode the anticipated synergy, weaken the market power, even lose competitiveness; A reasonless executive compensation structure will increase the conflicts of interests between owners and managers, negatively affect corporate performance which is related to market share, control of penetration etc.		

		Solution: Companies should enhance companies' internal self-regulation mechanism--independent auditors, employee-ownership, and maintain a sustaining friendly relationship with employees, toughen pay-for-performance metrics.		
	Managerial overconfidence	**Problem**: may overestimate the synergy gains of the potential merger.	**Problem**: inadequate post-merger planning causes M&A failures, bad performance, the decrease of market share, shrink international coverage etc.	**Problem**: managers always stay on the same level, may lead to the loss of competitive advantage as more and more entrants enter such contestable markets quickly.
		Solution: Managers should overcome overconfidence especially in high-risk cross-border M&A; board of directors should prevent and keep alert of managerial overconfidence.		
	Shareholders	**Problem:** shareholders' different interests, may exaggerate the potential synergy, impact the decision whether to M&A or not.		
		Solution: More communication with shareholders is needed for managers; the decision-making process going transparency is the trend to meet the information needs from shareholders.		
	organizational culture	**Problem:** culture clash in the combined company may erode the anticipated synergy savings.		
		Solution: Managers should recognize organizational culture differences and take into account when making decisions.		
	CEO	**Problem:** pursue his own interests, personal factors such as old age to retire.		
		Solution: Corporations should introduce an independent party or organization to supervise CEO.		
External	Country norms and value	**Problem**: pre-condition of generating synergy.	**Problem**: pre-condition of gaining market power.	**Problem**: pre-condition of controlling penetration.
		Solution: management should understand target's host country's culture, such as value and ethics that will determine the nature of a corporate management style, governance and communication custom, and decision makers' interests and behavior etc. to process the cross-border M&A smoothly.		
	Stock market	**Problem:** Almost every M&A activities even not really happened (rumors, news, announcement about possible M&A)		

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<tr><td></td><td colspan="3">Solution: management should communicate with the media and govern itself on its activities, in order to convince the society to perceive the corporation and its activities as a “responsible citizen” and will not harm the interests and benefits of the domestic parties.</td></tr>
<tr><td></td><td>Competition</td><td>Problem: enormous synergy will threat the growth of small and medium sized firms in the industry, which is</td><td>Problem: dominant market share will magnify the control of market and induce unbalanced competition and monopoly.</td><td>Problem: unbalanced competition will threats the survival of the peers by dominating the distribution</td></tr>
</table>

		restricted by regulations of some stakeholder-based corporate governance		channel
		Solution: corporations should not only seek competitiveness regardless the unfavorable impacts on relationship-based and stakeholder-concerned corporate governance systems and consider the interest and right of local stakes, since Antitrust law might seriously block the M&A.		
	Competitors (Competitor is a corporation's external stakeholder. Since it functions differently than other external stakeholders, this framework will present as an independent factor)	**Problem**: in relationship-based and stakeholder-concerned corporate governance countries, antitrust law will reject the M&A if there was a threat to the survival of the industry peers.		
		Solution: In this kind of corporate governance, corporations should first follow the antitrust regulations and adopt a coordinate strategy that acquire and control the target's stake slowly in stead of 100% at once.		
	Nationalism	**Problem**: prerequisite of cross-border M&A approval and nationalism can induce the public voice and government intervention.		
		Solution: corporations should take nationalism into consideration in advance to estimate the riskiness incurred by it. Nationalism is not able to be eliminated in some countries, so corporations should understand the reasons behind and adjust the M&A strategy to comfort domestic stakeholders.		